

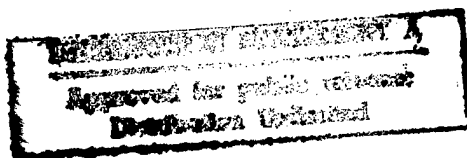
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5 DECEMBER 1986

# China Report

ECONOMIC AFFAIRS



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5 DECEMBER 1986

## CHINA REPORT

### ECONOMIC AFFAIRS

#### CONTENTS

##### PEOPLE'S REPUBLIC OF CHINA

##### NATIONAL POLICY AND ISSUES

Journal on Dual System in PRC Economic Reform (Zhao Renwei; JINGJI YANJIU, No 9, 20 Sep 86) .....	1
JINGJI YANJIU on Enterprise Ownership System (He Wei; JINGJI YANJIU, No 9, 20 Sep 86) .....	22

##### ECONOMIC PLANNING

From Sixth 5-Year Plan to Seventh 5-Year Plan Critiqued (Xu Xing; CHENG MING, 1 May 86) .....	35
--	----

##### ECONOMIC MANAGEMENT

Government Scales Back Capital Construction (XINHUA, 27 Oct 86) .....	47
--	----

##### FINANCE AND BANKING

Failure of Current Financial Reforms (Qian Jiaju; SHIJIE JINGJI DAOBAO, 29 Sep 86) .....	48
Senior Bank Official on Financial Reform (Liu Hongru Interview; LIAOWANG, No 39, 29 Sep 86) .....	51

##### FOREIGN TRADE AND INVESTMENT

China To Balance Foreign Exchange in 5 Years (Chu Baotai Interview; MING PAO, 24 Jul 86) .....	56
Shanghai Expands Barter Trade With Eastern Europe (Zhu Guangming, Ye Ren; WENHUI BAO, 3 Oct 86) .....	60



Shanghai Defense Industry Increases Civilian-Goods Exports (GUOJI SHANGBAO, 22 Sep 86) .....	62
Considerations for Promoting Shanghai's Export Trade (Jin Weizu, Min Yi; CAIJING YANJIU, No 5, 3 May 86) .....	63
Import Technology That Helps China Become Self-Sufficient (Yu Nan; SHANGHAI JINGJI, No 3, 31 May 86) .....	71
Plans for Shenzhen Overseas Chinese City Outlined (Liao Hui Interview; LIAOWANG OVERSEAS EDITION, No 33, 18 Aug 86) .....	76
Zheng Tuobin Discusses Recent Developments in Foreign Trade (CHING-CHI TAO-PAO, No 41, 13 Oct 86) .....	81
Abolition of Foreign Exchange Certificates Examined (Feng Muqing; CHING-CHI YU FA-LU, No 9, 1986) .....	85
China Develops Countertrade (GUOJI SHANGBAO, 23 Jun 86) .....	88
Good Potential for Zhejiang's Export Labor (Si Zhangfa; ZHEJIANG RIBAO, 24 Jun 86) .....	89
Briefs Anhui Metals Earn Foreign Exchange .....	92
SPECIAL ECONOMIC ZONES	
Shenzhen Bank First in Nation for RMB Deposits (Sun Shengzhu, et al.; GONGREN RIBAO, 20 Jun 86) .....	93
Shenzhen's Export-Oriented Economy (Li Kehua; NANFANG JINGJI, No 6, Dec 85) .....	95
Shenzhen Intensifies Export Work (TA KUNG PAO, 30 Jun 86) .....	108
Shenzhen Establishes Expert Panel To Review Imports (Wang Yougong; RENMIN RIBAO, 4 Oct 86) .....	110
TRANSPORTATION	
Plan To Strengthen Railroad Network in East China Announced (Cao Zhaoqin, Pan Yanxi; RENMIN RIBAO OVERSEAS CHINESE EDITION, 16 Sep 86) .....	111
Briefs Yenan Linked to Rail System .....	113
Anhui-Jiangxi Railroad .....	113

Bridge Spans Huang He	113
Anhui Builds First Freeway	114
New Changchun-Jilin Highway Opened	114
Port Expansion Projects	114

#### CHINESE MEDIA ON FOREIGN ECONOMIC AFFAIRS

Soviet Union Announces Reform of Foreign Trade System (SHENZHEN RIBAO, 25 Sep 86) .....	115
--	-----

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NATIONAL POLICY AND ISSUES

JOURNAL ON DUAL SYSTEM IN PRC ECONOMIC REFORM

HK100345 Beijing JINGJI YANJIU in Chinese No 9, 20 Sep 86 pp 12-13

[Article by Zhao Renwei (6392 0086 0251) of Economic Institute, Chinese Academy of Social Sciences: "Problem of the Dual System in China's Economic Reform"--written in July 1986]

[Text] I. The Dual System Is a Product of China's Structural Transformation Process

Reform of the economic system means changing from one mode of operation to another. Before China plunged into full-fledged reform of its economic system and witnessed the rise of an obvious dual system, many economists engaged in the study of economic reforms believed that in the restructuring of the economic system, every effort should be made to prevent the emergence of the dual system. The reason they gave was that every economic system had its unique operational mechanism and intrinsic logic and that friction and confusion would be inevitable if two different economic systems were jumbled together. (For example, Bu-lu-si [1580 7627 2448] maintained that "all systems of economic operation have, at various essential points, an intrinsic logic which is at once undamageable and independent.... More often than not, the result produced by eclectically jumbling together different elements of a variety of patterns is likely to be more disastrous than that of the average system which is not quite as efficient but is consistent. Thus,...the system of economic operation in a given period should, in principle, have a clearly-defined and presupposed pattern as its basis." See Bu-lu-si: "Socialist Politics and Economics," China Social Sciences Publishing House, 1981, p 19; also Bu-lu-si: "Problems of the Workings of the Socialist Economy," China Social Sciences Publishing House, 1984, p 193.)

In line with the above-mentioned reform theory, many economists, and in particular those in Eastern Europe, believe that insofar as the methods or steps of reform are concerned, a package plan should be adopted so that all principles of reform can play their part in all spheres involved. Their reasons are: First, piecemeal reform cannot dismantle the existing planned setup and bring about a fundamental change in the current principle and method of management. Once problems occur in the implementation of the new system, the old system will reclaim its lost

territory. Second, piecemeal practices cannot enable us to truly stick to the new principle of operation. The new system is only practiced in a number of enterprises. These enterprises are given greater decision-making power and are not subject to the mandatory targets set by the higher levels. However, when they turn to other enterprises for raw or semi-processed materials, the latter could refuse on the grounds that they were not so instructed by their higher authorities. This means that new production-supply-marketing relations cannot be established and that the new principle of operation will not be able to hold its ground. (See "Bu-lu-si on the Theory of Socialist Economic Patterns" in "Lectures on Foreign Economics," Book 3, China Social Sciences Publishing House, 1981, p 334) As they see it, if a double system comes about as a result of our adopting a progressive approach in reform, it is just like allowing some cars to keep to the left and others to keep to the right--confusion of traffic regulations is inevitable.

In the practice of economic reform, there is as yet no precedent of a successful transition from the old system to the new system through the practice of a dual system. For a brief moment in the late 1960s, the dual system was seen to be operative in reforms in a number of socialist countries. Due to resulting frictions and contradictions, however, things quickly reverted back to centralization and the dual system was replaced with the restoration of real mandatory planning. (See D. Granick: "Enterprise Guidance in Eastern Europe," Chapters 5-7, English Edition, 1976)

Although we have come into contact with the above-mentioned theory and experience during the initial phase of China's economic restructuring, the practice of reform over the past 7 years and more shows that we have been unable to keep the dual system from emerging. Since the launching of all-round economic restructuring with the emphasis on urban reforms, in particular, we have clearly and definitely entered the orbit of the dual system. The situation is far more complicated than the East European economists had anticipated. The dual system discussed by the East European economists chiefly meant application of the new system by some enterprises and application of the old system by other enterprises. The dual system in China, however, penetrated deep into the large and medium-sized state enterprises. In other words, in every enterprise there are some production-supply-marketing activities which operate according to the new system and some such activities which still operate according to the old system.

Since the implementation of the State Council's "Provisional Regulations on Further Extending the Decision-making Power of the State Industrial Enterprises" (the "Ten-point Document") in May 1984 and the "Decision of the CPC Central Committee on Reform of the Economic Structure" in October the same year, the coexistence of the dual system has become much more obvious and legalized. Enterprises which hitherto carried out production in accordance with mandatory plans now divide production into two parts--that which is subject to plans and that which is not (the plans here refer specifically to mandatory plans). The source of material supplies is similarly split, that is, some are obtained through unified state

allocation and others through free purchases. In line with this development, products subject to state planning are priced by the state by administrative means, while products outside state planning can be sold at a higher price (floating price, negotiated price and free price) which reflects the law of the market to varying degrees. (Note: According to the above-mentioned regulations of the State Council promulgated in May 1984, the price of goods to be marketed by the enterprises themselves may be allowed to float within a range of 20 percent above or below the price set by the state; from January 1985 onward, this restriction was removed.) The dual structure of planning, the dual structure of commodity circulation, and the dual system of pricing are three parts of an integrated whole. The dual structure of planning (which determines output) is the foundation of a dual economic structure; the dual structure of commodity circulation (which determines input) is the guarantee of the dual structure of planning; and the dual system of pricing is the concentrated expression of the dual economic structure as a whole in addition to being the focal point of the contradictions and frictions of the dual system which we discuss in subsequent paragraphs. Under the dual system, both the activities of the enterprises and the measures of macroeconomic control taken by the state bear a dual nature. Although the enterprises are given a fair amount of decisionmaking power, they are still subject to the constraints of administrative orders. For this reason, they cannot but keep one eye on the market and the other on the response of the higher authorities. State control over the enterprises is also a combination of direct administrative measures and indirect measures based on parameters.

At present, there is as yet no precise statistical data on the ratio of the dual system in the production and circulation of certain important products. Moreover, because mandatory plans at the central level are somewhat modified when transmitted to the provincial or municipal levels, the ratio as seen at the central and at the local level does not quite tally. According to figures supplied by the National Conference on Commodities Work held in early 1986, the number of commodities subject to unified allocation by the State Planning Commission and the State Administration of Supplies dropped from 256 to 23 in 1985; and the proportions of state allocated coal, rolled steel, timber and cement dropped to 50, 56.9, 30.7 and 19.4 percent of their total national output figures respectively. In 1985, the proportions of rolled steel, timber and cement acquired by various localities and enterprises from the market accounted for 38, 46 and 61 percent respectively of the total volume of such commodities consumed by the local enterprises. (See JINGJI RIBAO 26 February 1986. It is understood that some of the commodities acquired by various localities from the market are supplied to enterprises in the form of planned allocation.)

The dual system in China not only finds expression in the production and circulation of manufactured goods but is also seen to operate in the production and circulation of agricultural products. Since 1985, China had all along been enforcing a policy of unified procurement of grain, cotton, oil and other major agricultural products at prices set by the state. The dual system made its appearance in 1979 following the raising

of the procurement price of agricultural products. Under this system, products within the unified procurement quota are purchased at the procurement price, while above-quota products are procured at above-quota price (50 percent above the procurement price) and negotiated market price. Take grain for example. In 1984, the state procured about 40 million tons of grain at procurement, about 40 million tons at above-quota price, and about 45 million tons at negotiated market price.

Most people try to explain the emergence of the dual system in China's economic reform with the argument that we cannot change the pattern of our economic structure in a package plan and can only bring about the change step by step. No doubt this argument is correct. However, why do we have to carry out our reform step by step? Apparently we can at least carry out analysis on the following aspects: First, seen from the overall background of reform, it is very difficult for the whole country to switch from one system to another simultaneously and synchronically. This is due to a multitude of reasons, such as low productivity, backwardness in division of labor and commodity relations, the existence of a dual economic structure, great disparity between town and country, extremely uneven development between regions, the dual nature of economic growth types (the coexistence of growth by means of intension and growth by means of extension), relatively low educational standards, and the lack of management personnel and experience. Second, seen from the starting point and objective of reform, the fact that our economic structure was increasingly swayed by the military-communist supply system from the year 1956 when this structure was initially established up till the end of 1978 when reform was proposed at the 3d Plenum of the 11th CPC Central Committee due to "leftist" deviations in our guiding ideology, has made our existing structure more centralized, material-oriented, closed up and egalitarian than that in any East European country when we started our reform. However, this does not justify our lowering our reform objectives. After years of groping, the direction and objective of our economic restructuring have been clearly outlined: Instead of mainly relying on direct control, we are to mainly rely on indirect control. This actuality obviously demands a longer changeover period for our reform. Third, seen in terms of the reform process, it is impossible to bring about the reform overnight. We can only advance step by step. For example, the move from rural reform to urban reform, from reform in the realm of circulation to reform in the realm of production, from trial reform in selected enterprises and cities to reform in a great number of enterprises and cities, even reform on a national scale, and from reform in coastal regions to reform in the hinterland, all involve a progressive course. Fourth, seen in terms of our anticipation in the reforms carried out, it takes time to bring about a change in our economic development pattern, to raise the level of development, to improve the economic environment (by striking a balance between total supply and total demand), to rationalize the economic structure, to adjust the principal behaviors of the economy, and to transform the regulatory and control mechanism of the state.

## II. The Merits and Demerits of the Dual System

The coexistence of two systems is an indication that the impasse of the original system has been broken and new vitality has been injected into economic life. Thus, the dual system is, no doubt, an improvement over the ossified system. Its positive functions may be summarized as follows:

1. It is conducive to step by step readjusting the relations between people with respect to economic interests and reducing the perturbation about and resistance to reform.

Reform of the economic structure inevitably involves the readjustment of interpersonal relations of economic interests, and every major measure of reform is bound to bring about a change in the relations of economic interests between the state, the collective and the individual, between enterprise groups and between resident groups. Too drastic a change will generate a sense of perturbation among the public and therefore increase resistance to reform. The dual system can produce a cushioning effect. For example, pricing agricultural products too low was a problem left over by the old system. Since the upward readjustment of the procurement price for agricultural products would involve the readjustment of the relations of economic interests between the state, the peasants and the staff and workers, the range of price increases had to be subject to the wage level of staff and workers and the financial situation of the state. In order to prevent too drastic a change in the relations of economic interests between various quarters within a given time, our only alternative since 1979 had been to try, by various means, including unified purchase, procurement at a higher price (eventually these two practices were combined to form a system of fixed quotas for purchasing), making purchases in the market at negotiated price, and setting prices at different levels, to break the original pattern of unified purchase. Experiments in certain places in recent years show that it is not yet possible to bring about a par between the price for fixed-quota purchasing and negotiated market price. An upward readjustment will subject the state and the staff and workers too heavy a burden, while a downward readjustment will dampen the enthusiasm of the peasants. Thus, the only way to correctly handle the relations of economic interests between various quarters is to preserve the dual system of pricing for some time. In the production and circulation of manufactured goods, the dual system plays a similar role. While it is impossible to abandon the original system just like that, what we can do is to partially retain mandatory planning, let products subject to such plans continue to be produced and circulated as before and preserve the original pattern of economic interests by means of planning pricing. Meanwhile, the production and circulation of products not subject to mandatory planning can be channeled into the orbit of regulated markets, and the inter-personal relations of economic interests can be partially readjusted by pricing that reflects the law of the market. For example, thanks to the practical readjustment of the unreasonable structure of economic interests under the original system, with the price for mineral products being set too low and that for processed manufactured goods being set too high, some of those

enterprises with deficits are now beginning to make profits. The situation where some people suffer while others are having a great time under the unreasonable pricing structure has also been somewhat improved. The dual system, as a transitional measure, can spread the risks of reform and reduce major shocks into minor tremors.

2. It is conducive to increasing production and supply and mitigating the contradictions between supply and demand.

Those enterprises which used to carry out production and marketing completely in accordance with mandatory plans now have the power to produce and market as they see fit products outside the state plans. This has greatly boosted the enthusiasm of these enterprises for production. At this point, pricing has, to a certain extent, become the parameter regulating the production, supply and marketing, even the investment activities, of the enterprises. To some extent, enterprises can also make a positive response to price signals. Many enterprises have tried, by all and every means, to tap their potentials and raise funds to finance technical transformation aimed at enlarging their production capacities. As a result, the production and supply of products previously in short supply have increased, and the effects of shortages are not quite so noticeable. The mitigation of the contradictions between supply and demand has brought about a downward trend in the pricing of products outside the state plan. The gradual readjustment of agricultural procurement prices discussed above has also effectively boosted agricultural production, with the result that China, rather than having to import major agricultural products as it did in the past, is now self-sufficient in grain and more than self-sufficient in cotton. The dual system has also partially changed the picture of "production of production's sake" under the old system. This is conducive to invigorating circulation and promoting the coordination of production and demand. Supply departments have also begun to change their image from units that only handle planned allocations to units that provide service.

3. It is conducive to making economic use of resources and raising the level of enterprise managers.

Under the old system, production tasks carried out to meet mandatory plans were preconditioned by cheap supplies provided by the state and there was a lack of internal drive for enterprises to make economic use of resources. While our high coefficient of materials and fuel consumption has a lot to do with the low level of our industrial technology, low prices have, to a certain degree, protected this backwardness and encouraged waste. Under the dual system, there are two channels in addition to unified allocation by the state whereby enterprises can obtain the supplies they need: Purchasing products marketed by state enterprises themselves and purchasing products produced by township and town enterprises. Because these goods are sold at negotiated price, the buyers or consumers have to carry out strict budgeting and cost accounting and work hard at making economic use of raw and semi-processed materials and fuel, or try to find suitable substitutes. To the enterprise managers,



particularly those who are accustomed to the conventional operating mechanism, this is an opportunity for them to learn, to gradually understand and familiarize themselves with the law governing market operations and to raise their level of operation and management.

However, there seems to be controversy over the demerits, or negative aspects, of the dual system. The coexistence of two systems has led to the duplication of microeconomic decisionmaking and macroeconomic control and thus brought about a series of contradiction and frictions in our economic life.

1. In the process of the supersession of the old system by the new, a vacuum is often formed between the two systems of operation. What this means is that because measures of indirect control have failed to promptly ease into the gap left by the relinquishing of direct measures of administrative control, economic life is thrown into disarray and confusion. The runaway situation in revenue and expenditure, credit spending and currency issuance, the inflation of investment and consumption and other such phenomena seen in the fourth quarter of 1984 were, to a large extent, the result of this gap in the process of the supersession of the old system by the new.

2. Under the situation where two systems coexist, there is confusion in our signal system particularly our pricing signal system. The fact that the same commodity may bear more than one price tag has undermined the role of money as a universal equivalent and resulted in a dual measure of value, which goes against the principle of the identity of prices. This kind of confusion has brought about a series of frictions in our economic life. For example, because products subject to planned pricing bear a cheaper price tag than those that are not, some such products have been sold as products not subject to planned pricing. This has resulted in more and more contracts concluded between enterprises not being honored and has affected the fulfillment of plans formulated. Statistics show that compared with 1984, a drop was seen in 1985 in the fulfillment rate of contracts for 12 types of products, including rolled steel. Because of the duality of their behaviors, the enterprises, in their capacity as production and marketing units, will try their best to force down the mandatory planned quota in order to spare more production capacity on the production of products not subject to state planning. In their capacity as purchasers and users of raw and semi-processed materials, however, they will strive to seek bigger quotas for materials subject to unified allocation. Under the dual system, it is very difficult to develop a unified socialist market mechanism and competition mechanism. This makes it hard for enterprises to compete on an equal footing under uniform conditions of pricing. There will also be confusion in the criteria for assessing the performance of enterprises, because the standards for output value, sales volume and profits regrettably do not quite reflect the true picture. The disparity between the quoted price and the market price is also providing a breeding ground for speculation and the seeking of exorbitant profits. Huge profits are being pocketed by law-breakers in the realm of circulation and the number of irrational intermediate links has increased.

3. In the allocation and utilization of resources, the dual system has its positive side as described above. But then it also has its negative aspects. The high prices for products not subject to planned pricing will of course spur the production of certain commodities in short supply, which is conducive to the rationalization of the structures of different sectors. However, this has also encouraged some less efficient small enterprises to carry out production at a high cost, a move which results in the irrational utilization of our limited resources. This is also what caused uneconomic scales of operation and irrational structures within each sector. The rapid development of township and town enterprises in recent years has played a positive role in increasing production and employment, making up shortages, and so on. However, this has also given rise to the problems of small enterprises jostling with big enterprises and enterprises operating on backward technology jostling with those operating on advanced technology. The fact that some small enterprises are competing with the large enterprises for raw materials and power has reduced the economic benefits for society. Dual pricing has also encouraged the uneconomical transport of goods over long distances.

### III. An Analysis of Possible Solutions

People may come up with different solutions when confronted with the above-mentioned annoying frictions and contradictions. Summed up, there are the following four possibilities: 1) Switching back to centralization and the old system; 2) keeping the dual system as it is, even taking it as the target pattern and only adopting some remedial measures to reduce friction; 3) quickly bring the dual system to an end by making a swift transition to a system which puts the emphasis mainly on indirect control; and 4) treating the dual system as a state of transition from the old to the new and strive step by step to precipitate our entry into the orbit of the new structure. Now let us analyze these possibilities one by one.

In principle, we cannot deny the possibility of returning to the old structure. Moreover, we must particularly be on guard against the danger of turning the clock back. In terms of the difficulty of macroeconomic control, direct administrative control under the conventional structure is the simplest and easiest; indirect control under the targeted structure is more difficult; and macroeconomic control in a situation where two structures coexist and interlock is the most difficult and complicated. "The frictions and contradictions produced by the weakening of coordination by administrative means and the imperfection of market coordination under the dual system will present us, almost daily, with the difficult choice of whether to turn the clock back or to continue with the reform." (See Liu Guoguang [0491 0948 0342] et al: "Reform of the Economic Structure and Macroeconomic Management--Commentary on the 'International Seminar on Macroeconomic Management,'" JINGJI YANJIU No 12, 1985.) People have always had differing views on the runaway situation and inflation in the fourth quarter of 1984 and the tightening-up measures adopted in 1985. Some comrades maintained that the main problem lay in the excessive relaxation of policies in 1984, others said that the main problem was too much tightening in 1985. Regardless of the difference in people's understanding, the danger of turning the clock back is an objective

fact nonetheless. Some comrades said: "The policy of tightened-up macroeconomic control now practiced in China has four principal aspects: The scale of investment is controlled by targets, with heads of various localities and departments assuming full responsibility; the volume of credit is controlled by a specified amount, with the banks practicing a method of 'seeking uniformity': consumption funds are controlled by a base figure and managed by a special wage fund account; and energy and raw and semi-processed materials in short supply are controlled by planning and are mostly allocated. These tightening up measures may be summed up as the old method of administrative control." They also described this as "a quiet retrogression under the banner of strengthening macroeconomic control." (See He Xiaoding [6320 2556 2639] et al: "Two Points of Comment on the Abrupt Drop in the Rate of Economic Growth," SHIJIE JINGJI DAOBAO, 16 June 1986.) We are not going to pass judgement on whether or not this kind of evaluation of some of the tightening up measures adopted since 1985 has taken everything into account, but there is no denying that this view has incisively pointed out the possibility and danger of our turning the clock back. Of course, we should see that under the situation where both structures coexist, the direct means of administrative control have not been completely relinquished. In particular, under specific circumstances (such as the runaway situation discussed above), the strengthening of certain administrative measures can hardly be avoided. At such a time, we must pay attention to the following two points: First, direct administrative control must be kept within the bounds of necessity and must not be abused because it is simple to carry out. Second, the purpose of resorting to such measures should be to create the necessary conditions for the switch to mainly indirect control and must not make this a habit and thus bring about retrogression.

It appears that no one has yet explicitly put forward and systematically expounded and proved the view of preserving the dual system, or taking the dual system as the target model. However, if we observe carefully, we will find that such views are indeed present. We started our reform of the economic structure without sufficient theoretical preparation and subsequently moved onto the track of the dual system with or without our being conscious of it. In fact, the view which rather unconsciously regarded the transitional form of what is now called the dual system as the target model was once quite popular. In the discussions on the problems of planning and the market before 1982, the idea of taking the combination of mandatory planning, guidance planning and market regulation as the goal of the reform of the economic structure, particularly the view which held that the major part of total output value should be subject to mandatory planning, was predominant. Although the term "dual system" was never used in these discussions, the coexistence of mandatory plans with specific targets and plans which only give parameters (guidance planning) was in fact a dual system. Moreover, I think that the view which takes the combination of planning and the market mechanism as the goal of reform can rarely break itself free from the limitations of taking the dual system as the goal (to be further elaborated). Similar views can still be read in economic literature in recent years. Some comrades said: "Although mandatory planning is to be proportionally reduced in the system of planning as a whole, it does not mean that it is becoming

less important. It is still the foundation and core of the entire system of planning. The sliding weight of a steelyard may be small, but it can balance something very heavy.'" "The old structure may be full of defects, but it is socialist nonetheless. Both the new and the old structures are socialist in nature, why must one perish and the other thrive." (See Guan Mengjue [7070 1125 6030]: "The New Structure Does Not Mean a Complete Break from the Old" in JINGJI SHEHUI TIZHI BIJIAO [comparative study of economic and social structures], No 3, 1986.) Other comrades believed that the 2-tier system of pricing capital goods will thrive or perish, as the case may be, with the regulatory form which combines planning with the market mechanism. According to this view, the dual system will continue to exist as long as the regulatory form which combines planning with the market mechanism is there. This view has obviously made permanent a measure which is transitional in nature and has in fact brought down the goal of our reform. In the long-term, it runs counter to the intrinsic logic of the workings of an economic structure. As a result of this, the "internal wear and tear" produced by frictions between two structures will become an old drawback of the prolonged coexistence of the dual system rather than a cost we have to pay during the course of reform.

In view of the confusion brought about by the coexistence of two structures and seeing the danger of a return to the old under existing circumstances and the problem of intensified economic fluctuations, some comrades advocated that we should speed up the transition. For example, some comrades were of the opinion that "the transition should be made as early as possible because the 'double-track system' is doing us more harm than good." (See Zhao Linru [6392 2651 1172]: "Some Questions Concerning the Price Reform," JINGJI GONGZUOZHE XUEXI ZILIAO [Study Materials for Economic Workers], No 7, 1986.) "The most fundamental countermeasure is to introduce as soon as possible measures that ensure better coordination between macroeconomic and microeconomic control in order to establish a more complete structure of the commodity economy. We are not given much time. The most important thing now is to brace ourselves for the difficulty and extricate ourselves from the present predicament." (See He Xiaodong et al, "Two Points of Comment on the Abrupt Drop in the Rate of Economic Growth," SHIJI JINGJI DAobao, 16 June 1986.) Still other comrades said: "The economic fluctuations in recent years stem from the fact that the new and old structures are locked in a stalemate." "The fundamental way out...lies in breaking down this stalemate so that the new economic mechanism can quickly play a leading role." (See Wu Jinglian [0702 2417 8834]: "Economic Fluctuations and the Dual System," CAIMAO JINGJI [Finance, Trade and Economy], No 6, 1986.) We can perhaps call this kind of view the theory of rapid transition and term and viewpoint to be discussed later on as the theory of gradual transition. Here, I think it is necessary to make a distinction between an equilibrium between two structures and the coexistence of two structures. The former means that the two structures are evenly matched. The latter means that during the changeover period, one structure plays the leading role while the other plays a subordinate but not insignificant role; in other words, no structure is dominant. If this distinction is an appropriate one, then the theory of rapid transition discussed above can in fact be subdivided into two theories: The first is that the coexistence of two

structures will quickly be put to an end and replaced by a new structure where indirect control is dominant. The second theory only envisages an early break in the stalemate so that the new economic mechanism can play its leading role at the earliest possible date; but it cannot quickly bring an end to the coexistence of two structures. The theory of rapid transition in the latter sense is in fact not much different from the theory of gradual transition. It is only in the former sense that we see an obvious distinction. The anxiety of the advocates of the theory of rapid transition to put an early end to the sufferings brought on by frictions between the two structures is understandable, but it seems that they have underestimated the cost we have to pay in the course of the reform.

In view of the complexity and formidable nature of our reform, some comrades believed that while we should strive to shorten, as far as possible, the duration of the coexistence of two structures, the length of the period of transition is determined by objective conditions and not by man's subjective wish. If we force a transition when conditions for the all-round establishment of an indirect control system are not yet present, the result is most likely to be contradictory to our expectations and the resultant confusion and fluctuation may be more serious than when the two structures coexisted. This author basically agrees with this view. Everyone knows how complicated China's conditions are. Even in Hungary, where conditions are much simpler, the goals of reform have not yet been attained nearly 20 years after the reform began in 1968. It is still in a transitional stage. According to Ke-er-nai's [4430 1422 1143] analysis, although the reform in Hungary has already gone through the stage of conventional structure (IA) which featured direct administration coordination, it has not yet reached the stage of the market coordination structure (IIB) and is still practicing the transitional system of indirect administrative coordination (IB). Of course Hungary's IB system is different from our present dual system. This is because Hungary has abolished mandatory planning since 1968. However, on account of the massive presence of indirect administrative intervention, the typical behavior of Hungary's state enterprises is their double dependence on higher authorities and the market mechanism, with the weight on the former. From the angle of the duplicity of the behavior of enterprises, we could perhaps rightly call the IB system a dual system in broad sense. This realization does not mean that we should artificially prolong the frictions and agony of the transitional period. It means we must have a realistic idea of the necessity of the transitional period. Ke-er-nai said: "I am not at all certain that Hungary has to go through a period of transition from IA to IIB before IIB can be attained. History cannot repeat itself for purposes of experimentation. However, if a system has made the transition to a stage where the IB mechanism plays the principal role, it should be emphatically pointed out that this is no more than a transitional stage. If the reformers have cultivated long-term strategic thinking, are farsighted and can recognize that the economic reform will reach more far-reaching goals, the above-mentioned transitional stage is perhaps very necessary." (Ke-er-nai: "The Significance of Certain Hungarian Lessons to China's Reform," a paper prepared in 1985 for the "International Seminar on Macroeconomic Management." The quotes here are taken from the 1986 revised draft). It can thus be seen that the most

important thing is not to despair at the emergence of such a stage but to recognize its transitional nature with one's strategic foresight. Among comrades who recognize the need for a longer transitional period, views are not entirely unanimous as regards the exact length of this period. Some comrades said: "In order to achieve this kind of transition, we first must solve the problem of macroeconomic balance between total demand and total supply in the national economy. Unless this problem is solved, neither the double-track planning system, nor the double-track system of material circulation, nor the double-track system of pricing which is a concentrated reflection of the first two systems mentioned, will disappear." And, because "the above-mentioned problem of macroeconomic balance cannot be solved at its very roots for the time being... it may be quite impossible to substantially shorten the time needed to make the transition from the double system to the new unitary structure and from double-track pricing to the new single-track price structure as some Chinese and foreign economists had hoped. This transition may cover the entire course of the reform of China's economic structure," (See Liu Guoguang [0491 0948 0342]: "Some Facts and Problems About China's Price Reform," CAIMAO JINGJI, No 5, 1986.) Although I am not sure yet whether or not the double system will last through the entire course of the reform of China's economic structure, it is perhaps quite appropriate to make this estimate: It is possible to end the confrontation or deadlock between the two structures within a fairly short time, but it will be quite some time before the coexistence of the two structures can be brought to an end for good.

#### IV. Macroeconomic Management in a Situation Where Two Structures Coexist

If the situation where two structures coexist indeed has to be maintained for some time to come, how we are going to carry out macroeconomic management amidst intricate and complicated conflicts and frictions becomes a very important question. The following are some of the measures we can take:

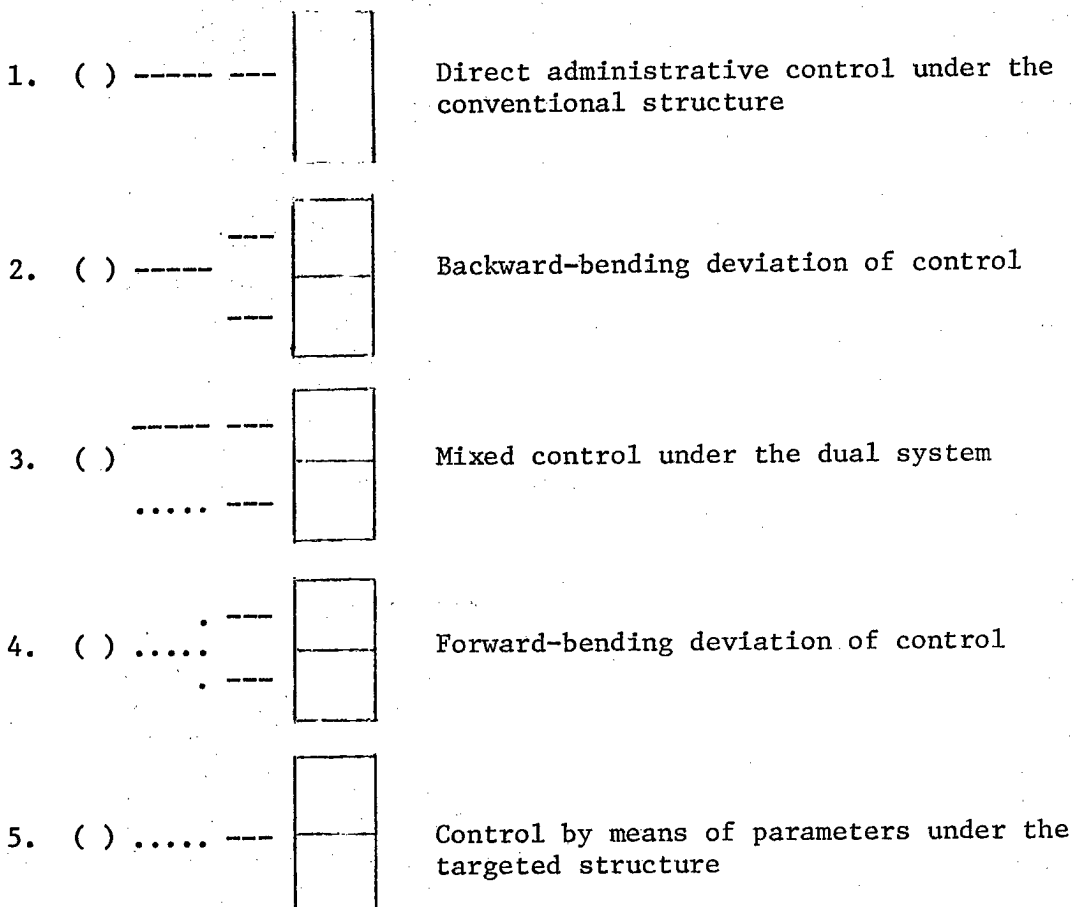
1. Efforts to gradually reduce direct control and gradually increase indirect control should be well coordinated. In other words, while allowing more freedom for macroeconomic activities, corresponding measures of indirect macroeconomic control should be adopted. Here, we must make two points clear. First, the weakening of direct state control over enterprises does not imply that economic activities will be left to take their own course and be guided by "the invisible hand." We must change the idea and habit of either exercising rigid control by administrative means or simply letting everything take its own course. We must also strive to learn the much more difficult method of carrying out indirect control by making use of economic parameters like price, interest rate, tax rate and wage. Second, the extent of the reduction of direct control is determined by the ability of indirect means of control to take over and not by subjective like or dislike. In other words, the reduction of direct means of control must be preconditioned by the formation of corresponding indirect means of control. We should exercise great care when planning every major move in our future reform and

properly handle the relations between construction and destruction. The analysis made by some comrades on the relations between economic fluctuations since the fourth quarter of 1984 and the dual system is quite inspiring. (See Wu Jinglian: "Economic Fluctuations and the Dual System," CAIMAO JINGJI, No 6, 1986.) However, I think that when we analyze the relations between the dual system and economic fluctuations, we must make a clear distinction between fluctuations which are unavoidable under a situation where two structures coexist and fluctuations produced by displacements in the changeover process (and the necessary tightening-up measures subsequently taken). In this way, we will be able not only to make an appropriate analysis of the evils of the dual system, but also to do our best to avoid fluctuations produced by displacements in the changeover process and hence reduce the extent of economic fluctuations. In other words, had we done better in learning how to control the dual system, particularly the changeover process, fluctuations to an extent we saw in the last couple of years might not have taken place.

2. Under the situation where the operating mechanism of the old structure still cannot be completely abolished, we must continue to rely on administrative orders to maintain the effectiveness and solemnity of this operating mechanism. (Mr Lin Zhiren [2651 5267 0086], the Oxford economist, had already noted this in 1984. See my article in JINGJIXUE DONGTAI [Trends in Economics], No 12, 1984). That is to say, in view of the interpermeation and friction between the two structures, measures should be taken to relatively separate the two structures so as to reduce the extent of the friction as far as possible. For example, for products produced and marketed by enterprises in accordance with mandatory plans and at a low price, the state must try, as far as possible, to provide relatively cheap supplies, uphold the principle of "low cost in, low price out" and "high cost in, high price out," and prevent the outflow of goods that come under mandatory plans of distribution. The honoring of supply contracts subject to mandatory planning should be guaranteed by legal means, and enterprises that fail to honor such contracts should be made subject to economic sanctions. Our Seventh 5-Year Plan for Economic and Social Development (1986-1990) clearly stipulates: "The state will improve the handling of means of production under its direct control. Those enterprises which refuse to accept orders in accordance with the state's distribution and allocation plans, or which fail to deliver goods according to contracts signed with the state, will be called to account and deprived of the right to sell their own products." (RENMIN RIBAO, 15 April 1986) These measures are adopted to ensure that enterprises can compete on a relatively equal footing in the absence of an environment for equal competition. Some comrades raised doubts as to the feasibility of the measures for relative separation. The reason they gave was that the outflow of goods that come under mandatory plans of distribution and their resale at a profit were unavoidable. While it is true that it is impossible to effect an absolute separation between two structures, it is possible, and indeed something of a necessity, to take measures to bring about a relative separation and try as far as possible to reduce the outflow of goods that come under mandatory plans of distribution.

Based on the above two points (the dovetailing of two forms of control during the changeover and the relative separation of the two structures), we may come up with the following five simplified diagrams. The circles [parentheses] represent central control or management organs; the blocks represent enterprises; solid lines [dashes] represent direct administrative control; dotted lines represent indirect control by means of parameters; and blocks cut into halves represent duplicity in the behaviors of enterprises under the dual system. In order to concentrate on analyzing the relations of enterprises to the state, I have omitted the interrelations between enterprises in the diagrams.

#### A Simplified Illustration of the Relations of Enterprises to the State



In these five diagrams, Diagram 1 shows direct administrative control under the conventional structure; Diagram 5 shows control by means of parameters under the targeted structure; Diagram 3 shows mixed control under the dual system; Diagram 4 shows the loss of macroeconomic control as a result of the abandonment of necessary administrative control after the emergence of the dual system or of excessive attempts to resort to indirect means of control when the objective conditions for indirect



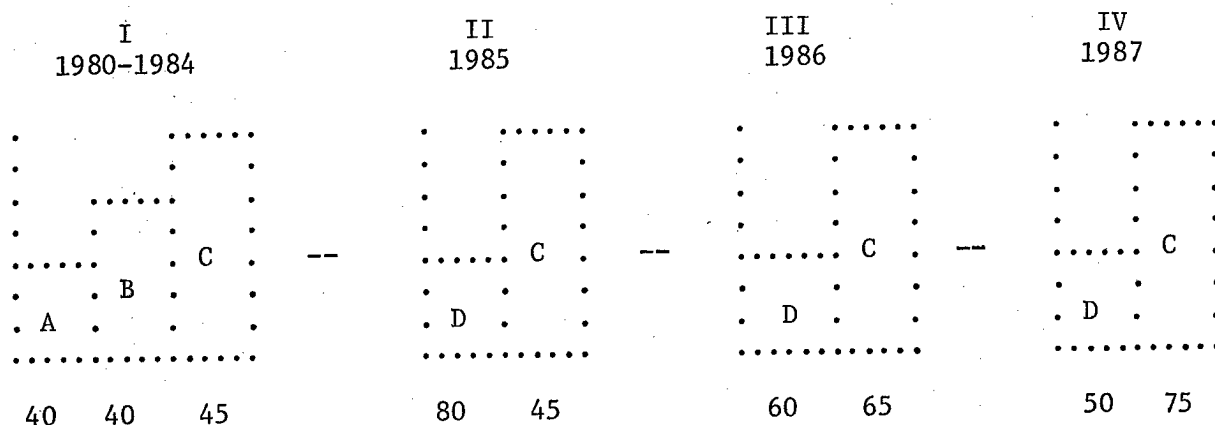
control are not yet ripe, a situation which may be described as the forward-bending deviation of control; Diagram 2 shows the excessive use of direct administrative control even after the emergence of the dual system, a situation which may be described as the backward-bending deviation of control. Of course the lines in diagrams 2 and 4 are oversimplified and can only represent a trend or tendency of deviation. Diagram 4 reflects, to a certain extent, the tendency of the loss of macroeconomic control in the fourth quarter of 1984, and Diagram 2 reflects, to a certain extent, the tendency to adopt tightening up measures to strengthen direct administrative control in 1985. These two tendencies of deviation were the cost we paid in learning how to make use of the dual system to achieve the goals of our reform. The state of control in Diagram 3 is a relatively good state under the situation of "seeking order out of disorder (the inherent confusion of the dual system)." But then diagrams are static, whereas the course of reform is dynamic. Thus, we must be able to grasp mixed control under the dual system and the process of changeover from the dynamic angle.

3. Under the situation where a fundamental change cannot take place in a state of the coexistence of two structures, we must make some adaptations to reduce frictions. An example of this is the measure taken by the city of Shijiazhuang to execute a unified price for important means of production. Since 1985, rolled steel and timber have been sold at market price in this city regardless of whether or not they are subject to planned distribution, and consumers have been purchasing what they need directly from the market. Because market price is higher than state quotations, the extras paid by various units for rolled steel and timber which were to be allocated according to plan are reimbursed by the supplies departments. This method has enabled the city to enlarge the autonomy of production enterprises in choosing and purchasing the best raw and semi-finished materials, reduce the number of intermediate links in the circulation of goods, change the situation where warehouses had to be set up at each and every level, and cut down expenses. This method is conducive to the conversion of supplies enterprises from organs or administrative management to service-oriented units. In particular, it helps to minimize such malpractices as going out of one's way to establish connections, entering by the back door and reselling allocated goods at a profit. Of course, in practicing this method it is still necessary to solve a number of problems, such as promptly making reimbursements for differences in price, and trying not to use up too much of the consumers' funds. (See Li Kaixin [2621 7030 0207]: "A Study on Developing the Market for the Means of Production," RENMIN RIBAO, 23 June 1986.) Moreover, this method only attempts to solve the problem of multiple pricing for the same product in the same market within the realm of circulation, and has not offered any fundamental solution for the problem of the mandatory allocation of the means of production. It is nevertheless an important experiment, and its role in easing frictions between the two structures is a positive one. We can imagine that as the reform deepens, people will gain more experience of a similar nature in the course of practice.

4. We can promote the relative growth and decline of the new and old structures through adopting measures that combine relaxation with readjustment. The transition from the system of direct control to the system of indirect control is materialized through the relative growth and decline of the new and old structures. More specifically, it is materialized through the interrelated processes of gradually reducing the proportion of goods that come under mandatory plans and increasing the proportion of goods not subject to such plans in production and circulation (the idea of "relation") and gradually effecting an upward readjustment in planned price so as to reduce the price parity between goods that come under planned allocation and those which do not (the idea of "readjustment"). This measure which combines relaxation with readjustment has produced some successful experience in the procurement of agricultural products, particularly in the procurement of grain. In the following paragraph we intend to analyze, through the use of diagrams, changes in the dual system of grain procurement since 1980. In the four diagrams illustrated below, the horizontal axes show the volumes of grain procured, while the vertical axes show the price level. In order to concentrate on analyzing the effects of the two factors of readjustment and relaxation, we have assumed the volumes of grain procured and the amounts of cash spent on the procurement of grain (that is, supply and demand) in various years to be constant. The figures below the horizontal axes were worked out on the basis of the approximate volume of procurement (unit: 1 million ton) in 1984. Between 1980 and 1984 (as illustrated in Diagram I), grain procurement comprised unified procurement, above-quota procurement (costing 50 percent more) and negotiated procurement at the market. In 1985 (as illustrated in Diagram II), unified procurement was abolished and unified procurement and above-quota procurement were combined in a system called fixed-quota purchases. In fixed-quota purchasing, price is worked out on the basis of 30 percent of the original unified procurement price and 70 percent of the original above-quota procurement price. During this year, the proportion of negotiated procurement at the market remained the same as before, but compared with the price gap between unified procurement and negotiated procurement at the market, the gap between the new fixed-quota procurement price and negotiated market price was reduced. By 1986 (as illustrated in Diagram III), the proportion of fixed-quota purchase has been reduced although there has not been any change in price. On the other hand, the proportion of procurement at negotiated market price has increased. If other factors are not taken into account, obviously there should have been a drop in negotiated market price and hence a narrowing in the gap between fixed-quota procurement price and negotiated market price. It is estimated that in 1987 (as illustrated in Diagram IV), the proportion of fixed-quota procurement will be further reduced and that of procurement at negotiated market price further enlarged. If other factors are not taken into account, the gap between the two will also be further reduced. From the changes in the dual system of grain procurement discussed above, we can see that elements of administrative orders are gradually diminishing following the abolition of unified procurement, the increase in fixed-quota procurement price (as against unified procurement price) and the reduction in the

proportion of fixed-quota procurement. On the other hand, elements of market mechanism are steadily growing as the proportion of negotiated procurement increases, and there is a tendency toward a narrowing of the gap between the two kinds of prices.

# An Illustration of Changes in the Dual System of Grain Procurement Since 1980



A equals Unified Procurement  
 B equals Above-quota procurement (at a higher price)  
 C equals Negotiated procurement at the market  
 D equals Fixed-quota procurement

[Broken lines in preceeding diagram are published as solid lines in original]

Obviously the experience we have gained from changes in the dual system of grain procurement will be of reference value in changes in the dual system in the reform of the urban economic structure. The production and circulation of industrial means of production in cities will also make the transition to the new structure through the implementation of measures which combine relaxation with readjustment. Of course, the capacity of society has to be taken into account when determining the pace of this process.

5. We must prevent the inflation of demand and strive to create an economic environment where total demand and supply are basically well-adjusted so as to minimize friction between the two structures. The extent of the conflicts and friction between the two structures is determined by the gap between the two kinds of prices; the bigger the gap, the greater the friction. On the other hand, the gap between the two kinds of prices has something to do with the degree of imbalance between supply and demand; the greater the extent of demand exceeding supply, the bigger the gap between the two kinds of prices. Thus, in order to minimize friction between the two structures, we must take as our point of departure the reduction of the imbalance between supply and demand in the macroeconomy. Based on the experience gained since the full-scale

launching of urban economic restructuring, the most important thing is for us to prevent and overcome the inflation of demand, including the inflation of investment and consumption. Of course the kind of limited buyer's market where total supply slightly exceeds total demand cannot be developed within a short time, but still we should move in this direction through controlling demand and increasing supply. There should be no doubt about this. It thus appears that the process of the relative growth and decline of the new and old structures and the process of the reduction of friction between the two structures coincide with the process of the gradual formation of a limited buyer's market.

#### V. Theoretical Inspirations Obtained from the Dual System

The progressive nature of the course of reform and the emergence of the dual system have prompted people to think about a great number of theoretical questions. Here I only wish to discuss some of my views on two questions.

First, the question of the relations between the length of the course of reform and the degree of development.

The length of the course of reform and the rate of progress are conditioned by many objective factors. Only by analyzing the objective conditioning factors in a realistic way can we make positive and safe arrangements in respect of the process and steps of reform. Political, social and psychological factors notwithstanding, in simple economic terms I think that the length of the course of reform is, at least, conditioned by the following factors:

1. The level of the starting point of the structural model, that is, the state of the old structural model from where the reform begins. If the level of the starting point of reform is relatively high, the course of reform may be shortened a bit. Conversely, the course of reform will be lengthened. As I see it, because our starting point is quite low, we must seriously take into account the effect of this low starting point on the course of our reform. (See Zhao Renwei [6392 0086 0251] and Rong Jingben [2837 2417 2609]: "What Was China's Old Economic Model?" JINGJIXUE DONGTAI, No 2, 1982.)
2. The choice of the targeted structural model. If the target is high, meaning that we take indirect control through the regulatory mechanism of the market, that is, through the use of economic parameters, as the target of our structural reform, then the course of reform will be a bit longer. If the target is low, meaning that we make some readjustments in the quotas of mandatory plans and do not change the nature of the directly controlled economic structure, then the course of reform will be a bit shorter.
3. Changes in the strategic pattern of economic development. Many economists considered the model of the economic structure to be a coefficient of the strategic pattern of economic development. A certain strategic

model of development requires a certain economic structural model to suit its needs. If the change from a development strategy which aims at rapid growth and relies mainly on development by extension to one which aims at meeting consumer needs and relies mainly on development by intension is a smooth one, then the course of economic reform can be shortened. However, if the change of the development strategy is not obvious, or if relapses occur from time to time, then the course of reform will be lengthened.

4. The degree of development. Here, the degree of development refers to the level of the development of the productive forces, mainly the degree of the socialization and commercialization of production. If the degree of development is high, then the course of reform can be shortened a bit. However, if the level of development is low, then the course of reform must be interwoven with the course of development and therefore lengthened.

In previously published literature on economics, quite a lot has been said about the effect of the first three factors on the course of economic reform, but not much has been said about the effects of the last factor. For example, on the relations between development and reform, more has been said on the relations between development strategies and reform than on the relations between the degree of development and reform. Nonetheless, the study of the relations between the degree of development and reform, particularly their effects on the course of reform, is no doubt a very important task. China is a developing socialist country where modern industries have long existed side by side with relatively backward industries and even conventional agriculture and the handicraft trades, and where the degree of the socialization and commercialization of production is quite low. As noted by some economists, developing countries like China are still in a stage of developing their semi-subsistence and semi-money economy. China still does not have an efficient market system. The scope of the commodity market is rather limited and often inefficient due to the uneven development between different regions and the backwardness of the means of transport and communications. The factor market (funds, labor, and so on) is even more underdeveloped. In a system of indirect control, however, the regulatory role played by various economic parameters is to a large extent determined by how well the markets are developed. When the markets are immature and the enterprises and individuals cannot quickly respond to the price, interest rate, tax rate and wage signals, these economic parameters cannot play a positive role in guiding the allocation of resources. It can thus be seen that at the present stage of economic development in China, it is impossible to establish a system of indirect control which embraces the whole society within a short time. Of course, this does not mean that it is impossible to establish such a system within a given scope where the degree of socialization and commercialization is higher. Strictly speaking, at the present stage of China's economic development, we will fall short of our goal whether we establish a system of direct control or a system of indirect control. Even when direct control was in its prime, the number of products subject to unified planning by the central

authorities lagged far behind that in the Soviet Union and the East European countries. (See Hua Sheng [5478 3932] et al: "Changing the Patterns of Economic Operation," JINGJI YANJIU, No 2, 1986) Some foreign economists said this by way of analysis: Since China's socialist economy is the low-income economy of a developing country, despite the fact that its original economic structure is one that may be defined as a planned material allocation system under centralized management, the role of this system is confined to a sector of the whole national economy due to the effects of low income. In carrying out economic restructuring aimed at utilizing the market mechanism, China cannot but take into account the constraining factors of "low income and low productivity." "As long as China's economy remains at the low-income stage, the effectiveness of the market economy will be confined within certain bounds." (See Shi Chuanzi [4258 1557 3320]: "The Socialist Economy and China's Experience--Prospects for the Economic Reform," KEJI DAobao [Science and Technology Reporter], No 2, 1986.) Perhaps we can say that in the near future we can only hope to initially establish a system of indirect control of limited depth and scope, and that it is only after the degree of commercialization has been further raised that this system can gradually spread and extend and operate more effectively.

Second, the question of the relations between planning and the market.

The progressive nature of the course of reform and the emergence of the dual system have also added a new aspect to the study of the question of the relations between planning and the market. As early as in the late 1970s and early 1980s, China's economists have had heated discussions on the question of the relations between planning and the market in the socialist economy. Culminating in the polemics between "the theory of the combination of two parts" and "the theory of organic combination." Put briefly, the so-called "theory of the combination of two parts" means that the production and circulation of goods should be separated, with one part to be regulated by planning and the other to be regulated by the market; the so-called "theory of organic combination" means that while the economy as a whole is to develop in a direction prescribed by state plans, the day-to-day economic activities of enterprises are to be brought into the orbit of the market and controlled and guided by economic parameters. In the light of the progress of the practice of reform, particularly the emergence of the dual system in the process of the transition from direct to indirect control, we can perhaps deduce the following new points of understanding on the question of the relations between planning and the market:

1. We must make a clear distinction between the two meanings of planning, for there is mandatory planning with specific quotas which is characterized by direct control, as well as guidance planning which is characterized by indirect control. According to Ke-er-nai, some of the disputes in previous discussions on the question of the relations between planning and the market arise from a blurred understanding of the two different implications of planning. (See Ke-er-nai: "The Significance of Certain Hungarian Lessons to China's Reform.") The same may hold true for China.

2. The first meaning of planning, that is, mandatory planning with specific quotas, and the market are mutually-exclusive. As one gains strength, the other is weakened. The strengthening of the role of planning means the weakening of the role of the market, and the strengthening of the role of the market means the weakening of the role of planning. The friction between the two structures to a large extent reflects this kind of relationship between planning and the market. Thus, if the combination of planning and the market, or the coexistence of two structures, as a transitory stage is something unavoidable, taking it as the targeted model is inadvisable.

3. The second meaning of planning, that is, guidance planning, blends well with the market. Guidance planning is characterized by the use of the regulatory mechanism of the market to attain the planned targets. Here, planning and the market represent an organic combination; they are the goals to be attained in the reform. It was not only due to the failure to distinguish between the two meanings of planning, but also due to the failure to distinguish between the targeted model and the transitory stage that some disputes arose in previous discussions. It was this muddle which caused the advocates of "the theory of the combination of the two parts" to deny the necessity to develop to the stage of organic combination and the advocates of the "theory of organic combination" to deny the need for the combination of the two parts in a given stage.

4. Under the dual system, planning and the market take on two aspects: Combination of the two parts, as manifested in the coexistence of the two structures and the friction between the two structures, and organic combination as manifested by the existence and development of the role of economic parameters within the domain of indirect control.

5. The process of the changeover from mainly direct to mainly indirect control is a process which sees the gradual phasing out of the aspect of the combination of the two parts and the gradual strengthening of the aspect of organic combination between planning and the market. Only when the transition from the old structure to the new has been completed can the organic combination of planning and the market be ultimately achieved.

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NATIONAL POLICY AND ISSUES

JINGJI YANJIU ON ENTERPRISE OWNERSHIP SYSTEM

HK291440 Beijing JINGJI YANJIU in Chinese No 9, 20 Sep 86 pp 38-44

[Article by He Wei (0149 0251) of the People's University of China:  
"Law of Development of Socialist Public Ownership System--Enterprises'  
Ownership System Is Not Collective Ownership System"--written in May 1986]

[Text] The socialist system of public ownership of the means of production is built on the foundation of socialized large-scale production. It is different from the primitive social public ownership system of an extremely low level of productive forces and is also different from the capitalist private ownership system of socialized production. The socialist public ownership system of the means of production can have different forms and each and every one of the forms continuously develops and changes following the development of the productive forces, such as the state ownership system, collective ownership system, ownership system of joint economic enterprises, social ownership system of joint bodies of free people, and so forth. Under the conditions of the nature of the public ownership system not being changed, these various forms of the socialist ownership system have their own laws of development. It is extremely necessary to study under what procedure and form they operate and develop.

I. The Problem of the System of Ownership by the Whole People Is Not Whether It Is Needed or Not, But That in Reality It Does Not Exist

The system of ownership by the whole people which we frequently talk about in reality does not exist; what exists is the system of ownership by the state.

First, the whole people is "not whole." According to its meaning, the system of ownership by the whole people means that the means of production are owned by people of the whole country, including not only the workers but also the peasants. In reality however, the peasants who make up 80 percent of the country's population do not have the ownership right of the means of production under the system of ownership by the whole people. They not only do not have the power of possessing, disposing, and using but also never have, in their capacity as owners, obtained any economic benefits from the form of distribution according to work. Thus, how is it possible to claim that the peasants are owners?



Second, the system of ownership by the state is not equivalent to the system of ownership by the whole people. Some people said that since at present the state is the representative of all the people, ownership by the state is ownership by the whole people, or, that the system of ownership by the whole people takes the form of ownership by the state. I am afraid that this claim can hardly stand. This conclusion is not the result of an analysis of the system of ownership by the whole people but is deduced from the logic of counter-analysis. The state is a political problem whereas the ownership system is an economic problem. The two cannot be mixed together. As a political structure, the state represents the interests of people of the whole country. Peasants as constituent members of the populace have seats in the congress of people's representatives for their representatives who represent the peasants' interests. The representatives act in the capacity of citizens, as members of the worker-peasant alliance, and have as their starting point the interests of the country as a whole and do not appear in the capacity of owners. Peasants are masters of the country. They can enjoy equal rights politically, carry out the masters' functions and responsibilities and protect the peasants' economic interests. But they cannot demonstrate that they are the owners under the system of ownership by the whole people, because peasants never have taken part in the production relationships of the system of ownership by the whole people and have only taken part in the production relationships of the system of collective ownership. They have never realized the ownership right of ownership by the whole people. Hence, being the masters of a country and being the masters of the means of production are two different things. They cannot be treated as one and the same thing; nor can they replace each other.

Third, the real form of the system of ownership by the whole people is the system of ownership by the state. The whole people being "not whole" mentioned above was said with reference to the owners it included; at the same time, seen as an economic entity, it does not exist and only the concept exists. Its economic entity is the system of ownership by the state but is not the system of ownership by the whole people in the currently adopted form of ownership by the state. Regardless of ownership by the state or ownership by the whole people, they are both a form of the existence of the socialist public ownership system. One form cannot become the manifested form of another form. Refuting the concept of the system of ownership by the people does not imply refuting the system of the ownership by the state, nor does it imply refuting the socialist public ownership system, far less changing the real nature of socialism. Resuming the original appearance of what is mentioned now as the system of ownership by the whole people--system of ownership by the state--conforms not only to socialist reality but also to the classical writers' discourse. Marx and Engels pointed out many times that the proletariat, after seizing power, must take over the means of production of the capitalist class, convert them into ownership by the state, and set up the system of ownership by the state. They did not point out that what the proletariat, after their seizure of power, set up was the system of ownership by the whole people, nor did they point out when the system of ownership by the whole people would be generated. If at the initial

period of the founding of the PRC, we had not copied wholesale from foreign countries but had realistically acknowledged that the system of ownership by the state, and not the system of ownership by the whole people, had been formed, then it would have been possible to escape the occurrence in 1958 of hastily effecting the transition from the system of collective ownership to the system of ownership by the whole people and the subsequent occurrence of a "poor transition."

## II. Steps in the Reform of the Form of the System of Ownership by the State

The socialist public ownership system set up by the proletariat after seizure of political power must take the form of the system of ownership by the state. This is because a socialist public ownership system cannot be germinated in the old society. Rather, it is necessary to depend on the strength of the state, to exploit the exploiters and set up a socialist public ownership system. However, following the development of socialist construction, revelation of the defects of the form of the system of ownership by the state has become increasingly clear. As stated in the "Decision of the CPC Central Committee on Reform of the Economic Structure": "No clear distinction has been drawn between the functions of the government and those of the enterprise; barriers exist between different departments or regions; the state has exercised excessive and rigid control over enterprises; no adequate importance has been given to commodity production, the law of value and the regulatory role of the market; and there is absolute equalitarianism in distribution. This has resulted in enterprises lacking necessary decisionmaking power and the practice of 'eating from the same big pot' prevailing in the relations of the enterprises to the state and in those of workers and staff members to their enterprises. The enthusiasm, initiative, and creativeness of enterprises and workers and staff members have, as a result, been seriously dampened and the socialist economy is bereft of much of the vitality it should possess." In order to solve these problems, it is necessary to carry out reform of the economic structure. "As Marxist theory and the practice of socialism have shown, ownership can be duly separated from the power of operation." Following this direction to carry out the reform, the state's power of operation and management over the enterprise is transferred to the enterprise, "so as to make the enterprise truly become a relatively independent economic entity, and become a producer and operator of socialist commodity production that is independent and responsible for its own profit and loss and capable of transforming and developing itself and that acts as a legal person with certain rights and duties."

At present, the problem is to what form the power of ownership and the power of operation and management should take to be considered as being "duly" separated and does the phrase "duly separated" have a designated quantitative character or a grading in intensity? Is it a concept of a static characteristic or a dynamic state, what are its prospects of development, and how is it possible for an enterprise to become a commodity producer and operator of commodity production? According to the law of development of the socialist public ownership system, the degree

of separation of ownership power and operation power may generally be divided into three stages and the system of ownership by the state must first pass through, either successively or simultaneously, the three stages before it can cross over to a new form of the public ownership system.

The first stage is the separation of the two powers with the new and old structures coexisting and the old structure still occupying a dominant position. At this juncture, the state is effecting the conversion of the structure from mandatory planning and unified responsibility for profit and loss to part mandatory planning, part guidance planning, and being in part self-responsible for profit and loss. The "Decision" pointed out: On the premise of the enterprise subjecting itself to the state's planned control, it is endowed with the following powers: "The enterprise has the power to adopt flexible and diversified forms of operation; plan its production, supply and marketing; keep and budget funds it is entitled to retain; appoint, remove, employ or elect its own personnel according to relevant regulations; decide on how to recruit and use its work force, and on wages and rewards; set the prices of its products within the limits prescribed by the state, and so on." These powers may be summed up to be the power of control over man, money, and materials. If an enterprise fully possesses these powers, then it can proceed by itself to carry out expanded reproduction. However, it must be seen that at present these powers have a large degree of flexibility. At a time of the coexistence of the new and old structures, it is inevitable that the enterprise has relatively large power in certain aspects and relatively little power in certain other aspects and at times has relatively large power, while at other times, relatively little power, and the separation is not at all stable. This is an inevitable stage in the full course of the state delegating its power to the lower levels. Generally speaking, at this stage, the old structure still occupies a dominant position. This is manifested in that the state controls both funds and materials, delegates power and at the same time takes power back, and in the course of delegating power, it asserts a relatively strict and tight control over funds and value while with regard to the material stature and use value its administrative control is gradually loosened. As for its control over materials, it loosens its control over some but keeps the control over others; it loosens its control over certain parts but keeps its control over certain other parts; sometimes it delegates its power a little more, and sometimes, less. But the general tendency is to continue on the road of delegating power, unable to stop and all the more unable to go back on the old road.

In the second stage, the new economic structure has been initially set up and a large framework has also been formed and commands a dominant position. At this juncture, regarding the enterprise, the state exercises its control only over value and not use value (orders for goods placed by the state and temporary measures of unified marketing are exceptions). In order to strengthen the state in using economic measures to enforce macroeconomic control and to solve the problems of the enterprise obtaining funds and materials from the old structure without shouldering

any obligations and obtaining advantages from the new structure without bearing any risks, it is still necessary to continue with the reform. This will require the powers endowed by the state to the enterprise to be fixed and protected by law, enabling the state and the enterprise to be equal to each other in power and in responsibilities, and the use of commodity relations and the contractual form to legalize the separation of the two powers. The enterprise being solely responsible for its own profit and loss and its autonomous operation must be protected and restricted by law and the status of the legal person being relatively independent must be recognized and maintained by law. At this juncture, the state's control over the enterprise's funds and material objects is in gradual transition to control over the funds. The state only supervises the value volume of the funds and no longer supervises the enterprise's funds in form of material objects and their use. By so doing, the relationship between the enterprise and the state only denotes that the source of the funds is from the state and the state is no longer the owner of the enterprise. Subject to the enterprise not violating any laws, in general the state has no power to intervene in the enterprise's operations and management. Only at such a time are the power of ownership and power of operation truly properly separated. At this juncture, the state's power over the enterprise is, on the one hand, the exercising of the state's functions such as the power of administrative control and the power of collection of the various kinds of income taxes; on the other hand, the state, as the owner of the funds, first collects from the enterprise fees for the use of the funds, so as to supervise the conditions of the use of the funds (the rate of the fee collected in general cannot be higher than the bank's interest rate on loans, otherwise the enterprise grade-differential charges formed by the objective conditions (such as abundance of natural resources, advanced equipment, good transportation facilities and so on). This will give the enterprises equality in competition.

During the period of the second stage, in the relationship between the state and the enterprises, only the problem of funds remains. But following the progress of the reform of the economic structure, two problems will appear which cannot easily be solved. One of them is that although the method of the state collecting a fee from the enterprise for the use of its funds can make the enterprise economize in the use of funds as well as increase the utilization rate, the volumes of funds used by different enterprises are different from each other. It may be assumed that those using more funds will make more profits and those using fewer funds will make fewer profits and cases will appear of the enterprises scrambling for funds from the state. The other problem is that since in capital construction the transformation from the financial department making the appropriation of funds for the project to banks financing the projects by loans, the enterprise is bound to repay the principal of the loan and pay interest on the loan at a scheduled time. After the enterprise has done so, the funds it still holds and uses will be entirely its accumulations and the situation will be like the enterprise using its own funds to finance its operations. Under such conditions, the existing enterprises will be in two different categories and positions: one category comprises enterprises which use the funds

of the state to finance their operations and the other category consists of enterprises which use their own funds to finance their operations. If the state adopts the same kind of policy toward the two categories of enterprises, obviously it will be to the disadvantage of the second category of enterprises. If this state of affairs continues, the enthusiasm of this category of enterprises will be affected. Hence, the reform must be continued.

In the third stage, the two powers will be completely separated following the state exercising its control over the value form of the enterprise's funds and its subsequent recovery of the whole investment. The state's investment in the enterprises should be gradually recovered in separate periods and separate batches so that all the enterprises will be in the same position. This will have the following advantages: First, the enterprises will be compelled to improve their operation and management; second, all the enterprises being in a status of equality, it will help in developing competition; third, the remaining relationship of economic dependence between the state and the enterprise will be completely severed, the independent character of the enterprises will be strengthened, and the undue interference from the upper levels will be stopped; and fourth, the state is enabled to utilize the invested funds recovered to increase the investments on the major construction projects or use the funds for other financial expenditures. As for those cases in which the enterprise is unable to repay or in which the total of the depreciation, profits, and taxes already paid out by the enterprise has exceeded the original investment made by the state, they should be duly considered at the time of formulating the concrete program of repayment of the state's investment. But the basic principle should be a thorough liquidation and accounting of the concerned enterprise's existing assets and require a categorical repayment. However, when determining the concrete figures for repayment, the figures can be slightly lower than the price that the enterprise may obtain if its assets must be auctioned.

By means of this step in the reform, the "umbilical relationship" between the state and the enterprise will be completely severed and the enterprise will no longer depend on oxygen from the state to continue to survive but will be completely separated from the material body and will rely on its own nutrition to grow independently. As we see it now, such an image seems peculiar but when we think deeper on the matter, we find that under a normal environment an enterprise should be solely responsible for its own profit and loss and bear the risks, otherwise enterprises under the system of collective ownership will have no way to survive.

Only when the reform of the economic structure has reached the third stage can the functions of the government and the enterprise be completely separated and can the system of ownership by the state be converted into the system of ownership by the enterprise. Only in special circumstances do some departments and enterprises still retain the form of ownership by the state. The form of the system of socialist public ownership crossing over from ownership by the state to ownership by the enterprise

is not a retreat but is an advance. The economic relationships of the system of ownership by the enterprise is better suited to the development of the productive forces. It is the reason for the existence of socialist commodity production, can arouse the enthusiasm and creativeness of the enterprises, workers and staff members, increase the vitality and motive power of the enterprise and promote social production. Seen from the present conditions of our country, not only does the system of ownership by the whole people not exist, but what the state owns has mostly become owned by the departments and regions, or owned by the subordinate governments at various levels, and little is left of the system of ownership by the state. This shows that the state cannot for long grasp the means of production. This is because the state is an upper-level structure, while holding of the means of production is a production relationship. In this way, the state is an upper-level structure and at the same time the economic foundation, likened to a person holding two jobs. Inevitably it happens that the upper structure commands the economic foundation and not the economic foundation that determines the upper structure. Continuing the temporary relations of the initial period of the establishment of the socialist system and treating the method of procedure at special times as being applicable to ordinary times will necessarily cause the appearance of many twisted and unreasonable phenomena. This will mean a lack in the system of ownership and compel people to continuously readjust the production relations and to rectify the errors in decision-making on the part of the upper structure. In the final analysis, this shows that the economic foundation determines upper-level structure and the readjustment of the reform itself illustrates that people are gradually adjusting the relationship between the two. This is proved in the separation of the functions of the government and the enterprise.

The above analysis shows that the system of ownership by the state is the product of special times when the contradictions between production relations and the productive forces become acute, and is not the unitary demand of the socialization of production. After the complete separation of the functions of the government and of the enterprise, although the state is no longer the owner and operator of the means of production, it is still the regulator of the various kinds of contradictions of the people, and needs to carry out macroeconomic control of the national economy, regulate the contradictions between the enterprise's interests and society's interests, regulate the contradictions between the various kinds of economic interests among the regions, departments, enterprises and people, and promote the coordinated development of the economy. In carrying out these regulatory functions, the state principally adopts economic, administrative and legal measures and, by means of various economic policies and parameters, facilitates the realization of the national economic plan. This constitutes the economic functions performed by the governments at various levels of the state. They no longer operate or manage the enterprises and the demand of separating the government from the functions of the enterprise is completely fulfilled.

### III. System of Ownership by the Enterprise is not System of Collective Ownership but the Embryonic Form of a Joint Body of Free People

The form of the so-called system of ownership by the enterprise is an attempt to find out a form for the transition from the system of ownership by the state to that of a joint body of free people. Marxist classical writers have not clearly mentioned when the transition from the system of ownership by the state to that by a joint body of free people would take place, whether before or after the vanishing of the state, and this is a problem to probe into. Because of its close liaison with the reform of the economic structure, people have come to grasp the law of the development of public ownership, making the current reform and future development possess generally the same tendency and making it possible to reduce the blind character of carrying out the reform.

Following the progress of the reform of the economic structure, the power of the enterprise has continuously increased, leading to the complete separation of the functions of the state and the enterprise. At this time, it should be said that the socialist public ownership system has adopted the form of the system of ownership by the enterprise (as for the particular name it should take, this is open to discussion; for the present, I temporarily call it the system of ownership by the enterprise).

First, an enterprise is an economic entity and possesses the status of a legal person. This is viewing the economic position of the enterprise from the legal angle. Viewing from the angle of vertical economic relationship, it is needless to say that in the complete separation of the functions of the state and of the enterprise, even under the conditions of the ownership power and operation power being duly separated (such as mentioned in the foregoing discussions on the second stage), the enterprise's funds are still owned by the governments at various levels which still have the final power of decision regarding the enterprise, although insofar as the production relations are concerned, the independent character of the enterprise is by no means affected. This is because, like the obtaining of loans from banks, the enterprise has the decision-making power and responsibilities of conducting independent accounting, being solely responsible for its own profit and loss and bearing the risks. This is similar to the relationship between loan capital and functional capital under capitalist conditions and also similar to the relationship between the landlord and the agricultural capitalist in which the enterprise should be under the ownership of the functional capitalist and the farm should be under the ownership of the agricultural capitalist. In such cases the source of the capital and ownership right of the land have no effect on the independent character of the enterprise and its status of a legal person. Between the enterprise and the governments at various levels the relationship is not a subordinate one like that between higher and lower levels but is a contractual one between power and obligation.

Second, the result of the reform of the economic structure will enlarge the lateral disparity of the enterprises. In the past, workers of the same grade in enterprises of the same category received the same amount

of wages. Their income was not related to the enterprise's operation conditions. Now, the economic benefits of the enterprise are closely related to the economic interests of the workers and staff members and of the benefits a portion consists of the enterprise's grade-differential income formed by non-objective factors. If the enterprise is run well, both the enterprise and workers and staff members receive more income; but if the enterprise is not run well, both the enterprise and the workers and staff members will receive less. Thus, the disparity of the income of the workers and staff members is widened, the problems of the enterprise "eating from the same big pot" at the expense of the state and of the workers and staff members "eating from the same big pot" at the expense of the enterprise are solved, and the phenomenon of egalitarianism in distribution is rectified, thus helping the implementation of the principle of material interests, arousing the people's enthusiasm and facilitating the development of production. As the "Decision" of the 3d Plenary Session of the 12th CPC Central Committee pointed out: "Only when some regions, enterprises, and individuals are allowed and encouraged to get better off first through diligent work can there be a strong attraction and inspiration to the majority of the people. More and more people will be prompted to take the road of prosperity, one group after another"; "The policy of encouraging some people to get better off earlier accords with the law of socialist development and is the only road to prosperity for the whole of society." Hence, with the public ownership system of the means of production as the basis, in the implementation of the policy of separation of the two powers, although in both cases both are the owners of the means of production and serve under the system of distribution according to work and although workers of the same grade actually expend the same kind and same volume of labor, yet because the two are working in two different enterprises, their remuneration is different from each other. Under the conditions of the enforcement of independent accounting, being solely responsible for one's own profit and loss and possessing the power of decision-making, nobody can do anything with regard to this disparity in distribution, otherwise the practice of "everybody eating from the same big pot" will once again prevail. Changes in the disparity in people's income which follow the operation conditions of the enterprises very much resemble the system of collective ownership in which the enterprise is the unit and which internally carries out distribution according to work. The use of self-owned funds by enterprises to carry out expanded reproduction will also lead to increases in the disparity of people's income.

Third, viewed from the angle of the autonomous power in operation of the enterprise, great changes are seen when a comparison is made with the original enterprises. Reform of the economic structure enables the state, basically through the implementation of guidance planning, to realize the balanced development of the national economy. Independent accounting, being solely responsible for one's own profit and loss, and economic benefits determine that the enterprise, in exercising its autonomous power in operation, should follow the demands of the market, changing the past practice of production for fulfillment of the plan to production for obtaining profits. People should view such



conditions as a normal phenomenon and should not criticize or take the enterprise to task. At this point, the enterprise's economic interests can be derived only from its own operations and the unified responsibility for profit and loss on the part of governments at various levels is abolished. Hence, we should not intervene in the enterprises' autonomous operations. As for the appearance of practices such as "big operation for big profit," "small operation for small profit," and "no operation for no profit," they only denote that we have not used the economic levers well. The responsibility does not belong to the enterprises but principally to the departments in charge. In reality, the appearance of this kind of phenomena precisely illustrates that under the conditions of a commodity economy the role of the market mechanism is unavoidable. It provides the state with information for its macroeconomic control and the use of economic levers in rectification is needed. This is a normal phenomenon and should not scare us into using administrative measures to intervene.

The changes in the three aspects as mentioned above show that enterprises have a definite ownership power and that the system of ownership by the enterprise is a form in the transition of the system of ownership by the state to ownership by a joint body of free people, being a form of the public ownership system which is different from the system of collective ownership. Its difference from the system of collective ownership is principally shown in the following aspects:

1. Different sources of capital funds. In a real system of collective ownership, its capital funds come from contributions from the constituent members of the enterprise. The participants must put in capital funds and means of production and those retiring from the enterprise take away their contributed capital. On the other hand, the source of the capital funds under the system of ownership by the enterprise is not the group contributions of the constituent members of the enterprise. They come from the state or from the accumulations of the enterprise itself. Constituent members of the enterprise have no direct relations with the capital or means of production. People participating in, or leaving, the enterprise are not related to the capital funds or with the problems of the increase or decrease of the capital funds of the enterprise.

2. Properties of enterprises under the system of collective ownership belong to the collective all of the constituent members of which are the owners, whereas the ownership right under the system of ownership by the enterprise does not belong to the constituent members of the enterprise but to society, that is, publicly owned. A portion of the constituent members of society, following a definite procedure, join together and use in common the publicly-owned production materials and funds. Their responsibility not only is to enable the workers to work in the enterprise but also to earn the individual's labor income therefrom. Moreover, their responsibility is to see that the enterprise's properties will not decrease but continuously increase. But under the conditions of the level of the productive forces at present, the possession of the enterprise by a portion of the people has the character of repelling others'

possession. This character of repelling gives the enterprise definite collective economic interests as a result of which it has the elements of a collective economy. But these elements are not derived from the character of the public ownership system but from the repelling character of the possession. Hence it is the reason for the existence of commodity production under socialist conditions. Once the development of the productive forces causes the elimination of the repelling character of the possession, commodity production will cease to exist and the system of ownership by the enterprise will cross over to the joint body of free people.

3. The system of ownership by the enterprise is also a developed form of the system of collective ownership. At its start, the system of collective ownership can still discern who are the owners of the capital funds, but after a period of time, with the increase in the enterprise's accumulations and the development of expanded reproduction, it becomes very difficult to identify who are the owners of the capital funds and who are not. As collective economy develops and the individual's income is increased, the concern of the constituent members is no longer the ownership right of the capital funds but the operation conditions of the enterprise and the size of the individual's income. Under socialist conditions, the source of the individual's income is principally distribution according to work and not the possession or ownership of the capital funds. In particular, under the conditions of allowing the personnel to circulate or move about, it will bring about the separation of the constituent members of the collective from the original collective economy. The workers in the collective economy may not necessarily be the original investors while the original investors may not necessarily work in the enterprise in which they have invested. At this juncture, the enterprise under the system of collective ownership has made the transition to the system of ownership by the enterprise, being not much different from the ownership system of other enterprises. Therefore, the future of the development of the system of collective ownership is not the system of ownership by the whole people, but the system of ownership by the enterprise.

4. The grade-differential income of enterprises under the system of collective ownership belongs in its entirety to the collective and society should not make any levy on it, but the grade-differential income formed by objective causes under the system of ownership by the enterprise should be so levied by society and should not be retained by the enterprise. This denotes the difference in the form of the ownership system between the two.

5. The system of collective ownership is frequently in liaison or associated with the peasant class but the system of ownership by the enterprise no longer has any class ties and is owned by the constituents of society. Because according to the law governing the development of the public ownership system, the development should be from the collective ownership system of the system of ownership by the state to the system of ownership by the enterprise and not the system of collective ownership

developing into the system of ownership by the whole people, from now on it will be difficult to differentiate the classes by means of the form of the system of ownership. At present, in the rural areas the township and town enterprises have a population of over 60 million people. It is difficult to say that all of them are full-fledged peasants.

The form of the system of ownership by the enterprise is a transition from the classes, groups and the state separately dividing and possessing the means of production to society's unified possession of the means of production, being also a transition from possession of the means of production demarcated by people to possession by society without any demarcation. Before possession by society, possession by the enterprises comes first and finally transition is made to possession by society. All this is determined by the level of development of the productive forces. Under the conditions of the system of ownership by the enterprise, the leading persons of the enterprise are ipso facto the representatives of the ownership right of the enterprise. Here, the problem of the absence of ownership does not exist.

In the transition from the system of ownership by the state to the system of ownership by the enterprise, a comparatively good form is the leasing system because it can create the necessary environment for the form of the system of ownership by the enterprise.

First, the leasing system is applicable to enterprises of different types and to different forms of the ownership system. Small enterprises can use it and large and medium-sized enterprises can also use it. Under the large enterprises, different accounting units can be set up. For example, head offices can apply the leasing system to the branch factories and workshops under them. The Shenyang Motor Vehicles Company is using the leasing system in the case of its 21 branch factories, the largest of which has a staff of over 1,000 people. When the state allows the coexistence of mandatory planning and guidance planning, it can use the leasing system. When the state prefers principally guidance planning, the leasing system can also be employed. When the system of ownership by the enterprise is in vogue, employment of the leasing system will be all the better.

Second, the leasing system better manifests the demand for the separation of the two powers and separation of government from enterprise functions. Under the conditions of the leasing system, the enterprise's relationship with the upper level is a contractual one with equality in rights and obligations and it is no longer a subordinate relationship, being thus beneficial to making the enterprise become an independent economic entity and legal person. Delegating the enterprise downward to central cities and towns is no longer like changing a "mother-in-law," but is changing a superior with mutual economic relationships on an equal status.

Third, the leasing system is a better form of enforcing a real factory-chief (manager) responsibility system. Through the form of leasing, the operation and management power of the factory is given to the factory

head (manager). This enables his power of having full responsibility to be protected by law, endows the enterprise's relationship with the party, government and labor union and the relationship between its various levels of constituents with a new significance and content, categorically solves the phenomenon of nobody being responsible or having no way of being responsible and creates the conditions for correctly handling the economic interests between the three parties.

Through the form of leasing operations, it is possible to solve the difficult problems currently confronting the reform of the economic structure and it also possesses the following functions in solving the actual existing problems of the enterprise.

First, the leasing system categorically severs the umbilical relationship between the state and the enterprise, enabling the enterprise to make its own decisions and to bear the risks. This automatically solves the problems of the enterprise striving for more funds from the state and undertaking projects in a blind manner, thus helping in shortening the capital construction front and enabling the rational use of funds.

Second, the leasing system brings about delicate changes in the concept of the workers and staff members toward the factory head (manager). It renders it difficult for people to stay in the enterprise and live at the expense of socialism. It consolidates the labor organization, stiffens the labor system, strengthens labor discipline, achieves the objectives of rewarding the diligent and punishing the lazy, carries out distribution according to work, overcomes egalitarianism, effectively controls the granting of bonuses, prevents undue competition, and depresses the growth of the consumption funds.

Third, the leasing system solves the problem of the factory head (manager) serving and acting on a short-term basis. The duration of the lease and the contents of the contract determine the responsibilities and obligations that must be borne by the factory head (manager), the targets during the lease period, and the income he should receive as well as the guarantee fund that he must carry, thus enabling the existing factory head responsibility system to be further perfected and to possess new contents.

In short, enforcing the leasing system benefits the reform of the economic structure, and helps the transition from the system of ownership by the state to the system of ownership by the enterprise.

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## ECONOMIC PLANNING

### FROM SIXTH 5-YEAR PLAN TO SEVENTH 5-YEAR PLAN CRITIQUED

Hong Kong CHENG MING in Chinese Vol 103, 1 May 86 pp 18-21, 92

[Article by Xu Xing [6079 5887]: "From the Sixth 5-Year Plan to the Seventh 5-Year Plan--A Critique of Zhao Ziyang's Report on the Seventh 5-Year Plan"]

[Text] Why was it not possible for Communist China's economy for so long a period to break out of the vicious circle of periods of disarray and readjustments? The fundamental reason is its system, which leaves those making strategic policy decisions on investments free from any responsibility for the consequences of these investments, a system that has remained unchanged to this day.

The Fourth Session of the Sixth NPC, which ended on 12 April, was primarily concerned with the economy, but also with the civil code and the law on compulsory education. But the most important item was its endorsement of the Seventh 5-Year Plan. At the said session, Zhao Ziyang gave a "Report on the Seventh 5-Year Plan," in which he dealt with foreign policy and also with the economy, treating the latter subject in two parts, part one being a review of the implementation of the Sixth 5-Year Plan, and part two a discussion of the key points in the Seventh 5-Year Plan and of the reform of the economic system for the duration of the Seventh 5-Year Plan.

#### Achievements During the Sixth 5-Year Plan and Comparisons

The term "Sixth 5" refers to the Sixth 5-Year Plan, which lasted from 1980 to 1985, precisely the time when Chinese agriculture underwent its transformation from a collective system to the household contract responsibility system also precisely the time when China opened up to an entrepreneurial economy and instituted a reform of its economic system, which on the whole brought prosperity to the entire economy and made Zhao Ziyang acclaim this period in his report as the most outstanding among all previous 5-year plans since the founding of the PRC.

The economic achievements during the Sixth 5-Year Plan, of which some people are so proud, are entirely due to the reforms, in other words due to the CPC abandoning its ultra-leftist pattern of a petrified socialism, which had been given priority over the objective laws of economics, a pattern that had insisted on "taking class struggle as the key link," in agriculture "cutting

off the last tails of capitalism," and in industry emphasizing "revolution as the driving force." Only by abandoning this ultra-leftist economic pattern of the past was it possible for China to revive vitality in agricultural production, in the urban and rural enterprises and in other nongovernmental enterprises. But this is not meant to imply that performances during the Sixth 5-Year Plan had been superior in all respects compared with performances during all previous 5-year plans.

Communist China officially published the gist of Zhao Ziyang's report, together with a table comparing the main items of capital construction carried out during all past 5-year plans (see following table).

**Comparison of Main Achievements During the Sixth 5-Year Plan  
in Capital Construction in the Fields of Energy Sources and  
Transportation by Units Owned by the Whole People**

5-Year Plans:	1st	2nd	3rd	4th	5th	6th
Completed Large & Medium Investment Projects (Numbers)	184	179	240	248	129	103
New Coal Extraction Capacity (10,000 tons)	6376	14920	6806	8121	6493	8000
New Electric Power Generating Capacity (10,000 kW)	246.9	863.8	860.4	1743.2	1929	1951
New Petroleum Extraction Capacity (10,000 tons)	131.2	816.6	2777	4104.2	3975.3	5025
New Railway Lines Opened to Traffic (km)	4861	4890	3978	5444	2951	1544
New Double-Tracking of Railway Lines (km)	894	2816	1016	530	1186	1577
Newly Electrified Railway Lines (km)	0	90	197	385	1000	2459
Increased Handling Capacity at New Deep-Water Berths (10,000 ton)	835	1572	1311	4747	7031	10039

**Note:** New petroleum extraction capacity comprises renovated and rebuilt capacities and capacities added through new investments.

This table reveals: 1) During the Sixth 5-Year Plan the number of completed large and medium-sized investment projects was not larger than of those completed during all previous 5-year plans (of course, capital construction projects should really not be measured in numbers, but rather be judged by their actual significance for overall economic development); 2) The increase in coal extraction capacity newly added during the Sixth 5-Year Plan was larger than during the Fifth 5-Year Plan, but smaller than during the Fourth and Second 5-Year Plans; 3) The increase in electric power generating capacity newly added during the Sixth 5-Year Plan was not much more than the increase during the Fifth 5-Year Plan; 4) During the Sixth 5-Year Plan fewer new railway lines were added than during any other 5-year plan period (which seems to show that railway constructions during the Sixth 5-Year Plan consisted primarily not in the laying of new lines, but in the repair of old lines, electrifications and double-tracking).

## Backward State Remains in Energy Sources, Transportation and Telecommunications

Let us now examine the actual current condition of those of China's problem areas--energy sources and transportation--which Communist China has repeatedly and emphatically pointed out as key targets for remedial efforts, by listening to what certain NPC delegates and members of the Political Consultative Conference [PCC] had to say in their statements at the present NPC and PCC meetings.

Chen Zhaohua [7115 0340 5478], a delegate from Henan Province, said: In 1985 nationwide coal production reached 80 million tons, of which one half came from small local mines, and some apprehension seems justified as to the lifetime of such local mines. Chen Zhaohua considered present coal prices unduly low, a cause of widespread losses in the coal industry. In addition such factors as the reform of worker wages, increases in the prices of raw and semifinished materials, and the large-scale shift from agricultural to nonagricultural pursuits has increased the burden on the coal mining enterprises. Without an adjustment in coal prices, coal mining enterprises cannot possibly be sustained by merely relying on tapping existing potential.

Lu Qinkan [7120 2953 0179], PCC member and senior engineer of the Science and Technology Information Office of the Ministry of Water Resources and Electric Power, said: During the Sixth 5-Year Plan, the gross output value of industry and agriculture increased at an average of 11 percent annually, but the average annual rates of increase in the sources of energy and power generation were only 5.7 and 6.3 percent, respectively, with an elasticity coefficient of energy sources of only 0.41 and in electric power generation an excess over the previous coefficient of only 0.58. "There is no progress here, but rather a regression."

Mao Henian [3029 7729 1628], a delegate from Jilin Province, said: Although great successes are said to have been achieved in China's electric power industry, the continuous shortage of electric power has not only not been alleviated, but grown more serious during the Sixth 5-Year Plan. In the Seventh 5-Year Plan, industry and agriculture is to grow at an annual rate of 6.7 percent, but electric power is to be increased by only 6.2 percent, a situation which certainly cannot make up for the acute shortage of electricity. He therefore called for the adoption of a "slanting policy," to cut down investments in other industries and use such funds rather to develop the power industry. He believes that without effective measures during the Seventh 5-Year Plan, "time will have run out."

Even more despondent were opinions of NPC delegates and PCC members with regard to the backward state of China's telecommunications. Ye Peida [0673 1014 1129], PCC member and honorary president of the Beijing Posts and Telecommunications Institute, complained that his telephone call from Shanghai to Beijing took 2 1/2 days to get through, also that the connection was very poor. As far as we know, microwave telephone lines using glass fiber have been installed in China in recent years, with the cooperation of the Hong Kong Telegraph Office, in more than 20 places in Fujian, Guangdong and Tianjin, but

no such lines have been laid in such major cities as Beijing and Shanghai, making it still very difficult to talk long-distance between Beijing and Shanghai. The installation of microwave lines is one problem; another problem is whether there are sufficient telephone sets in the cities. Liu Xuanlun, [0491 1357 4858], PCC member and deputy director of the Chongqing Posts and Telecommunications Institute, said: In China there are currently only 0.5 telephones per 100 persons, while in the United States there are as many as 80 telephones and in Washington even as many as 180 telephones per 100 persons. The comparison shows how very much backward China's postal and telecommunication services are, a state of affairs that is completely inadequate to satisfy the needs of the modern information age. Liu Xuanlun also said: In the 34 years since the founding of the PRC, the state has invested only 6 billion renminbi in its postal and telecommunication services, only a little more than half the amount of the state's investment for only the first stage of the Baoshan Iron and Steel Mill project.

The backwardness of China's telecommunications is a result of Mao Zedong's long-standing policy of keeping the people in ignorance. Mao has been all along against developing communication enterprises, because the more the people exchanged information the less would they be amenable to his rule. The spirit behind this policy of keeping the people in ignorance still prevailed during the Hua Guofeng era; Hua was not averse to paying a huge sum to the Japanese for the importation of the Baoshan installation, but would not think of devoting a major effort to the improvement of telecommunications between the people. It was only recently discovered, with Deng Xiaoping's emphatic call for the development of the economy, that the backward state of telecommunications is detrimental to economic development. Only then was serious attention drawn to the development of telecommunications. Liu Xuanlun said: The CPC Central Committee has by now become aware of this problem and decided on a trifold development of postal and telecommunication services by the end of this century. At that time, telephones should be in wider use, up to a rate of 2.8 sets per 100 persons. This would still be far below the 1982 world standard, which is indeed a matter of extreme concern. (In 1982 Hong Kong had 34 telephones per 100 persons--author's note)

#### Reasons for the Declining Grain Production

In many parts of his report, Zhao Ziyang praised the achievements of the Sixth 5-Year Plan period, but only perfunctorily glossed over the shortfalls during the same period with a few smooth and short phrases. This method seems to go one better than Hu Yaobang's standard of "news to be only 2 to 8 parts open," somewhat adopting Mao Zedong's rule of "the ratio of nine fingers to one finger." In whatever shortcomings Zhao Ziyang mentions, we can therefore find not even one word about the decline in China's grain production.

According to the statistical report on the national economy and social development during 1985, published on 8 February of this year by the State Statistics Bureau, grain production in 1985 had declined 7 percent compared with 1984. However, the Beijing correspondent of the Hong Kong WEN HUI BAO, Cheng Xiang [4453 5046], mentioned that some estimate the actual decline to have possibly been as high as 9 percent. Calculated at the rate of 7 percent, the shortfall would have been about 28 million tons, while at the rate of 9



percent, it would amount to about 34 million tons. The following statistics show total grain production during several years before and after the reform in agriculture:

1979	332.12 million tons
1980	320.56
1981	325.02
1982	354.50
1983	387.28
1984	407.00
1985	378.98

Note: Figures for 1979 to 1983 are from "The Glorious 35 Years--Statistical Data for 1948 to 1984," published by the China Statistical Publishing Co. The figure for 1984 is from Zhao Ziyang's Report to the Third Session of the Sixth NPC. The figure for 1985 is from the 1985 Statistical Report, published February this year, by the State Statistics Bureau.

Above table reveals that last year's grain production was not only below that of 1984, but also below that of 1983. This is a disquieting situation. It is precisely in this connection that the Ministry of Agriculture began in the spring of this year to mobilize over 3,000 cadres for dispatch to various localities, where they are to work together with the local cadres in prevailing upon the peasants to grow grain. Immediately after conclusion of the NPC and PCC meetings, Zhao Ziyang himself hurriedly called a meeting of all provincial governors to study the problem of this year's agricultural production.

Why did grain production decline last year? Du Runsheng [2629 3387 3932], director of the Center for Rural Development in the State Council, said in reply to questions by reporters at the first news conference during the NPC meeting: "The decline was primarily brought about by natural calamities." Blaming the decline in agricultural production on natural calamities is a propaganda trick consistently employed by Communist China, a propaganda trick that frequently hides the true reasons for a production problem. However, Ma Jianyou [7456 1696 3731], a PCC member and director of the Neijiang Agricultural Science Institute of Sichuan Province expressed it well when he listed five reasons: 1) farmland occupied and used for nonagricultural purposes, reducing the acreage of arable land year by year; 2) peasants preferring commercial over agricultural pursuits, resulting in land being left uncultivated; 3) increases in the acreage planted to cash crops and reduction of area planted to grain; 4) reduction of government investment in farmland; and 5) neglecting the dissemination of agricultural technologies.

#### Reduction of Farmland Due to Its Diversion to Other Purposes

Communist China itself acknowledges the existence of the evil trend to divert the use of farmland to other purposes. In the last few years, the CPC Central Committee and the State Council promulgated many laws and regulations to stop this practice, but all to no avail. On 2 April this year, the Central Committee and the State Council again issued a joint circular notice, strictly

forbidding the said practice. The notice reads: "The problem of nonagricultural constructions in urban and rural areas, indiscriminately occupying and misusing land, continues to persist on a wide scale. In some places these practices are even still sharply on the increase. The indiscriminate occupation of farmland and misuse of land by village and county enterprises and construction of houses in rural areas has become an extremely serious problem. In many places farmland has become greatly reduced. In some provinces, the reduction of farmland during one single year amounts to the area of farmland of a medium-sized county, and in some suburban areas the peasants are left without any land to cultivate." This is forcibly supplemented by the statement of Lin Shaonan [2651 1421 0589], NPC delegate from Hubei Province, who said: Every year, from 1980 to 1984, farmland in that province occupied and diverted to other purposes amounts in area to the farmland of a small county, so that in the course of 5 years, the said province lost at least the farmland of 5 small counties. Wang Juyuan [3076 5468 3220], PCC member and deputy director of the Garden Bureau of Beijing Municipality, said that from liberation to 1982, the country's farmland has been reduced by 470 million mu, and in the one year of 1984 the reduction was 500 million mu, even larger than the total decline during the preceding 34 years!

Why is farmland occupied and diverted to other purposes to such a large extent? The reasons are that, apart from some land needed for highway and railway constructions, some land is taken up by the expansion of cities and some land has been taken up by township and town enterprises or by the construction of houses by peasants. Although it is said that land in China belongs to the state, peasants can transfer land use rights against remuneration. In transfers of this nature, some of the recipients of the land use rights may indeed divert the use of the land to improper purposes, but fundamentally these transfers or occupations of farmland are actually the natural result of economic developments, and it is therefore a development that cannot be stopped by any kind of command.

#### Township and Town Enterprises Drawing Off Agricultural Manpower

The development of village and township enterprises is not only the cause of occupation and diversion of farmland, but also a cause for the diversion of much agricultural manpower.

On 30 January this year, the correspondent of the ECONOMIC NEWS was informed at the All-China Economic Conference that the total output value of China's township and town enterprises in 1985 was 251.2 billion yuan (renminbi), an increase of 47 percent over 1984, yielding a net profit of 24.7 billion yuan. This information will greatly assist us in an assessment of the proportion taken up by village and township enterprises within the rural economy as a whole. According to statistics of the State Statistics Bureau, the gross output value of agriculture in 1985, after deducting the value of village-run industrial production, was 357.5 million yuan, so that the ratio of total output value from township and town enterprises in relation to total agricultural production was 7 to 10. If this situation is allowed to continue, one may well predict that within 1 or 2 years the total output value from township and town enterprises will exceed the total value of the entire

agricultural production.

Based on the same source of information, the ECONOMIC NEWS reveals that these township and town enterprises are to 56.3 percent located in the eight provinces and municipalities of Jiangsu, Zhejiang, Guangdong, Shandong, Liaoning, Beijing, Tianjin and Shanghai, and to a very small percentage in the northwestern and southwestern regions of Nei Monggol, Ningxia, Xinjiang, Gansu, Qinghai, Yunnan, Guizhou and Guangxi. It may therefore be inferred that the abandonment of farm work by peasants is mainly taking place in the areas of greatest development of township and town enterprises.

Currently, a concept is gaining acceptance in the Chinese countryside, expressed in the saying "no trading, no prosperity." The peasants understand the term "trading" as referring not purely to selling of goods over longer or shorter distances, but to commercial operations in general, including the operation of township and town enterprises. The reason for this concept is that profits from commercial undertakings and from the operation of enterprises by far exceed profits from farming. Under the conditions of a commodity economy, investors are bound to be drawn to the areas of highest profits, and if we consider labor as a kind of investment, labor too will naturally move to areas of highest remuneration. The restlessness of the peasants in agricultural production merely indicates that the profits from agricultural production are too low. Arriving at a true understanding of how to apply the laws of economics in guiding the Chinese economy, Communist China will have to spur itself and start out by tackling the problem of how to increase profits in agricultural production. There is really no need to dispatch a large contingent of 3,000 cadres into the countryside to pressure the peasants to grow grain. Pressure by so large a contingent amounts in actual fact to direction by administrative means or issuing orders, and certainly not to guidance of the economy by an application of the objective laws of economics.

#### Rendering Science and Technology Research in Agriculture Self-Supporting

The most effective way to raise profits in agricultural production is raising the scientific and technological level of farming, as exemplified by the experiences of the United States, Europe and Japan, and also by the experiences on Taiwan. Yet Communist China seems to have never in past years given serious attention to this aspect. In statements at the present NPC and PCC meetings, I was therefore surprised to discover that Communist China finally adopted a policy of "rendering agricultural research self-supporting." The term "self-supporting" most likely means that the agricultural research organizations themselves will have to find ways to raise funds for their own agricultural research expenses; the government will not allocate funds or perhaps allocate a limited amount for regular expenses. To leave the agricultural research organizations, which could possibly succeed in raising profits in agricultural production, to their own devices to survive, however, is unimaginable!

Wu Jingfa [0702 2417 4099], PCC member and deputy director of the Agricultural Research Institute of Dalian Municipality, said that an arrangement of having agricultural research conducted on a self-supporting basis will in reality

meet with the greatest difficulties, because agricultural research is a long, drawn out affair and often requires large areas for its experiments. Deng Xiancheng [6772 0341 6134], PCC member and senior engineer of the Heilongjiang Forestry Institute, said: When gradually carrying out the experiment of a self-supporting policy for agricultural research, several research units became disinclined to accept important research assignments from the state. Some units rather released a considerable part of their personnel to engage in commercial and service activities, where they made much money. As a result it became impossible to carry out normal research. Others too, among them Sun Zhongyi [1327 0112 6654], president of the Guangxi Agricultural College, and Zhao Congli [6392 0654 4409], assistant professor in the Forest Department of Yunnan Forestry College, expressed similar opinions.

Some of Communist China's leaders, probably dazzled with the success of the abundant 1980 grain harvest that resulted from introducing the household contract responsibility system, believed that China's grain problem had been solved once and for all. In actual fact, this system was merely a relaxation of the vicious hold by which Communist China controlled agricultural production. That relaxation has of course had a strong effect on the morale of the peasants, stimulating them to increase production, but it did not after all engender any changes in production technologies, and was therefore unable to bring about a radical improvement in the technological level of agricultural production, or raise its profits, the factor which is responsible for agricultural manpower being drawn off to areas of higher profits in the village and township enterprises or in commercial pursuits. If Communist China will not start out expending efforts on the solution of this fundamental problem in agriculture, the drain of agricultural manpower, decline in grain production and reduction of acreage under cultivation will continue to plague the development of Chinese agriculture for a very long time to come.

#### Rules Governing Progression of China's Economic Construction

For the period of the Seventh 5-Year Plan, Zhao Ziyang set forth 3 basic tasks and 5 construction policies. The 3 basic tasks are: 1) maintaining a basic balance between total social demand and supply, to create a favorable economic and social environment for the further reform of the economic structure; 2) controlling the scale of investments in fixed assets to ensure a steady growth of the economy; and 3) raising the economic results of production and improving living standards. The 5 construction policies are: 1) increasing the total value of industrial and agricultural production by an average 6.7 percent annually during the Seventh 5-Year Plan; 2) an overall investment in capital constructions by enterprises owned by the whole people of 500 billion yuan and the investment in equipment renewal of 276 billion yuan during the 5 years of the plan; 3) exploitation of intellectual resources; 4) enhancing the capacity to earn foreign exchange; and 5) raising the standard of living at an appropriate rate.

Steady economic growth in a communist country in which the state-owned economy is in dominant position is closely linked with the scale of investment in fixed assets and with the balance between the total social demand and supply, while the question of whether a balance can be achieved between total social demand and supply again depends on maintaining control over the investment in

fixed assets.

In a communist country, part of the total social demand and supply originates undoubtedly with the people, but it is a basic policy of communist parties to restrain the demands of the people, so that the people are always left with some of their demands not fully satisfied, but without any other alternative but to accept the fact of a constant shortage of supplies. Actually, the overall balance between social demand and supply, that the communist party speaks of, is primarily a consideration of the amounts of state investments in fixed assets. If state investment in capital construction is excessive, exceeding the state's intrinsic capacities and rendering it difficult for the state to meet supply needs, or to provide the needed funds, they call this state of affairs "excess of social demand," and call the consequences of this state an imbalance between total social demand and supply. Any such imbalance forces them to take steps to cut down on investments in capital constructions (also referred to as investments in fixed assets owned by the whole people), which will finally end up in a so-called adjustment of the economic policy. These are the rules that govern the progression of economic construction in Communist China, and this is also the true meaning of their relevant economic vocabulary.

#### The Long-Standing Problem of Inflation of Investments

The mentioned rules governing economic progression find expression in the Seventh as equally in the Sixth 5-Year Plan. For this reason, Communist China divided the Seventh 5-Year Plan into two periods. The first 2 years are to be a period of "consolidation, assimilation, supplementation and perfection." The latter 3 years are to be a period of regular development and of a reform of the economic system.

Communist China itself explains that 2 years of assimilation are needed because 1984 and 1985 had been years of inflation of investments, overheated consumption and of a large outflow of foreign exchange. Actually, inflation of investments is not a new problem as far as Communist China is concerned, but has all along been a persistent problem. The following statistical data show the repeated occurrences of inflation of investments subsequent to the downfall of the Gang of Four:

#### Investments in Fixed Assets by Units Owned by the Whole People

In 100 million yuan		Explanations
1978	668.72	1978 to August 1980 was the time of Hua Guofeng's premiership.
1979	699.36	Zhao Ziyang officially assumed premiership on 10 September 1980.
1980	745.90	1980 was called the year of the "great leap forward in Western relations."
1981	667.51	Due to adjustments in 1981, retrenchments were effected to somewhat below the 1978 level.
1982	845.31	In 1982 investments continued to rise.

1983	951.96	Sharp rise in first half of 1983, somewhat checked by rigorous measures of the CPC Central Committee, still exceeding 1982 by 13 percent.
1984	1,160.00	Investments out of control during second half of 1984.
1985	1,652.00	During 1985 investments continued out of control on a large scale.
1985	1,652.00	

Note: Data for 1978 to 1983 are from "The Glorious 35 Years--Statistical Data for 1948 to 1984," published by the China Statistical Publishing Co. Data for 1984 and 1985 are from the State Statistics Bureau Gazette.

#### Zhao Ziyang's Statement of 4 Years Ago

On the question of inflation of investments in fixed assets by enterprises owned by the whole people, Zhao Ziyang had made a specific statement in his report on the Sixth 5-Year Plan presented to the Fifth Session of the Fifth NPC in December 1982. He said:

"Experience in our economic construction over the past 30 and more years has proven time and again that the volume of investment in capital construction must suit national strength....Since the founding of the PRC, we have suffered several major setbacks in economic construction, all of which, apart from political reasons, can be attributed economically to the blind extension of capital construction. If the scale of capital constructions is excessive, it will not only be a strain on the supply of building materials and lengthen the construction cycle, but is bound to exert pressure on production, on maintenance and on the people's livelihood, making it impossible for enterprises to maintain normal production or for necessary improvements to be made in the livelihood of the people. When things came to a head, the economy had to be readjusted and many capital construction projects had to be discontinued, causing much overstocking of equipment and even total waste of large amounts of equipment. Many plants serving capital constructions had to reduce or even suspend production, and many workers were forced into idleness by such improper organization. The drastic losses and huge waste in the wake of excessive extension brought the most serious waste and harm to China's economic construction in the past. Once things started to go well again after readjustment, "the old malady" would reappear, and there would be again an indiscriminate expansion of capital constructions. The lessons we have learned from these experiences have indeed left deep impressions in us, and we must never again commit the same error."

This is what Zhao Ziyang said 4 years ago. His statement sounds equally topical today because after all these 4 years, the mistakes that had repeatedly occurred during the previous 30-odd years, and which should never have been committed again, are being committed again today.

Communist China is probably by now also too embarrassed to repeat the old refrain of "adjustments" in economic construction, and is therefore not using the term "adjustment" this time, but rather the word "assimilation," but the words "assimilation" and "adjustment" are actually used here as identical in

meaning. This has us inevitably ask the question: Why is it that Communist China's economic construction has to remain forever stuck in this circle, moving from "loss of control to adjustment to loss of control to adjustment," unable to break out of this repetitious circle?

### No Escape From the Vicious Circle

The fundamental reason for this problem, in my opinion, is primarily the system which permits it that those making the investment decisions need not bear responsibility for the consequences of their investments.

In the capitalist society, an individual investor will figure out over and over again what results he may expect from his investment. The investment by a corporation would have to pass careful scrutiny by the board of directors and would face inquiries at the shareholders meeting. Government investments would have to pass even stricter examination and face parliamentary inquiries and be exposed to the pressure of public opinion. In China, however, investments are carried out at the command of the upper level leadership, and results are never publicly supervised or inquired into. It will therefore happen that the upper level leadership will, for purely political reasons (not economic needs), want to brandish investments as political achievements and attempt what is beyond its actual capacity to accomplish. Even so large an undertaking as the Baoshan project, involving several billions of yuan, was decided upon in one stroke. Upper level leadership in Communist China is centralized yet multi-departmental. Large investments of the 5-year plans or annual plans could of course be controlled by the State Planning Commission, but the various ministries and commissions still maintain the power to effect extra-plan investments under a variety of pretexts. The loss of control over investments is indeed to a large extent occasioned by the upper level itself.

After the reform of the economic system is accomplished, it will become even more difficult for the state to control investments. The transfer of authority to lower levels will bring certain powers to effect investments to all subsidiary organizations of ministries, all provinces and municipalities, even counties and towns. Of course, the central authorities can impose monetary limits on whatever powers are passed to lower levels, but "whatever measures are decreed, a way will always be found to circumvent them." Organizations with investment powers will frequently start out by fixing the initial investment at an amount which is still within the predetermined scope, but will later expand these investments by way of supplements. The system of allowing enterprises to retain a part of their profits will add to the difficulties of controlling investments and will lead to situations such as the following: because enterprise units need not pay much attention to increasing their profits, they will frequently not invest the profits they are allowed to retain into improving their production equipment, but will invest these profits in nonproductive residential housing. As to diversion or shifting of funds away from the purposes they were earmarked for in plans or budgets, this has become a common practice in all organizations of Communist China, and is another reason for difficulties in controlling investments. Whether we look at the problem of inflation of investments or at the problem of losing control over investments, it is quite clear that a democratic government system is extremely important for economic development. If the

Communist Chinese government would democratize its decision-making processes, allow the decisions of the government to be submitted to societal and media supervision and true inquiry by the NPC and the PCC, it would greatly reduce or even eliminate the irrationality that the higher level authorities alone command all action. If the delegation of powers to lower levels in Communist China will not only be a delegation to the government's own subordinate officials, but will be a delegation of powers to the self-governing organizations at the local level, and have the self-governing organizations at the local level submit to the supervision of local public opinion, local people's assemblies and local consultative committees, it would go far to restrain the local bureaucrats in the misuse of their powers and would stop the iniquity of their not submitting to supervision and of their counteracting government policy.

But, Communist China could never bring itself to change its current political system to conform to the needs of the economic reform. Its economic policy is therefore doomed to remain stuck in a circle of "loss of controls--adjustments," without any possibility of getting itself out of this rut.

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CSO: 4006/1036



ECONOMIC MANAGEMENT

GOVERNMENT SCALES BACK CAPITAL CONSTRUCTION

OW271050 Beijing XINHUA in English 1037 GMT 27 Oct 86

[Text] Beijing, 27 Oct (XINHUA)--China's central government has been able to scale back pending capital construction to avoid unnecessary drains on scarce national resources, the ECONOMIC DAILY reported today.

Concentrating on postponing or eliminating unessential projects, the government was able to keep capital construction spending by state enterprises and agencies to 61 billion yuan during the first three quarters, far less than officials earlier in the year had feared.

As a result, the increase since the same period in 1985 was kept to 9.5 percent, compared to a 38.6 percent growth the year before.

"Most of the retrenchment came in local projects outside the state plan," the paper said.

But, the paper said, "taking the situation as a whole, there are still too many unessential projects and the investment on capital construction may end up exceeding the planned 17 billion yuan (4.59 billion dollars) by the end of the year."

In response, it said, government officials have called for "continued effort to retrench investment in projects outside the state plan."

Work on 64.5 percent of 190 key government construction projects for the year has been completed, according to the paper.

The paper said compared with 1985, construction priorities were more oriented toward the energy industry and less toward facilities for raw and partially processed materials.

Drilling at six major oil sites has reached more than 8 million meters, 78.5 percent of the annual plan, it said, while mining exploration at 15 major mines has reached 139,000 meters, 75.4 percent of the year's goal.

Railroad construction, however, has been running slightly behind, with 60 percent of top priority work completed on 17 major lines, according to the paper.

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CSO: 4020/42

FINANCE AND BANKING

FAILURE OF CURRENT FINANCIAL REFORMS

Shanghai SHIJIE JINGJI DAobao [WORLD ECONOMIC HERALD] in Chinese 29 Sep 86 p 2

[Article by Qian Jiaju [0578 1367 7467]: "Financial Reforms Have Failed to Change the Essence of the System"]

[Text] The serious loss of control over the money supply and bank lending in 1984 proves that China's financial reforms have not altered the essence of the fund supply system. Chinese enterprises are still eating from the "big rice pot" of bank lending; while banks are doing likewise with the issue of money.

Experience in recent years shows that the establishment of a central bank and assorted specialized banks has not only failed to wean banks from the old fund-supply system, but actually given it fresh momentum, as manifested by the fact that banks have become the source of all the circulating funds required by enterprises, lending them as much as they need. Second, the various specialized banks make loans in accordance with the old fund supply system. Third, enterprises and localities continue to eat from the "big rice pot" of bank loans. Many localities obtain loans from banks in the name of vitalizing the economy and doubling output value earlier than planned. The banks must lend them money, they argue, if they are to invigorate the economy. Otherwise, the economy will be "stifled." Thus the banks came under pressure from all quarters and bank lending got out of hand. As a result, the central bank has not become a genuine bank of currency issue. Nor have specialized banks become independently operated enterprises responsible for their own profits and losses. In reality, they are still fund-supplying organizations, whose scope of operations remains outside the effective control of the central bank. Fourth, that all kinds of trust companies, credit cooperatives, township and town enterprises, and individual households eat from the big rice pot--bank loans-- is a fairly widespread phenomenon. In the countryside, loans used to be made to units which purchased farm produce and sideline products, and other commune brigades. Today, in order to vitalize the economy, agricultural banks are under pressure to make a vast number of loans to township and town enterprises and individual households, most of which are never repaid. In the urban areas, all kinds of trust companies approach the banks for loans, some of which disappear as personal income while others are bad debts that cannot be collected.

In short, the new system has basically not changed the essence of the fund supply system. The investment system is still stuck in the traditional Soviet mold. Investments in expanded reproduction are directly decided by leaders who consider only need while ignoring results. Nobody is held economically responsible. Feasibility studies are not carried out and infrastructural projects are provided gratis. This model is ill-suited to the new situation characterized by the development of a commodity economy. Amid all the sloganeering about "vitalizing the economy," things often get out of control, as was the case in 1985 when there was no alternative but to tighten the money supply administratively, imposing "universal" controls in an attempt to curb inflation. This fully proves that this old-wine-in-new-bottle variety of financial reform has completely failed to meet the new demand of the restructuring of the economic system. This is an issue that we should look into thoroughly.

On the whole, China's current economic situation is good. But its primary latent crisis remains this: the scale of infrastructural development is too large, we have overextended ourselves, and the level of fixed assets investments continues to surge, all of which has not been brought under effective control so far. The Seventh 5-Year Plan originally projected infrastructural spending at 500 billion yuan; now it appears that even 600 billion is on the low side. The loss of control over investments in infrastructural projects is a major reason behind the nation's economic setbacks over the past 30 years. "The Great Leap Forward," the 10-year "Cultural Revolution," the "Foreign Leap Forward"--all suffered from it. How clamp down on overexpansion has become the most critical question at the moment.

Actually banks should play a "quality control" function with regard to investments in the infrastructure. If banks make investments in accordance with the principles of commodity economics and consider only the merits of a project and not the people involved, they should begin by conducting technical and economic feasibility studies. After a decision is made to proceed with the project, tenders should be invited and contractors strictly told to deliver the project on time and guarantee its quality. This way the anticipated economic results will materialize, while investments "hunger" will not recur. Nor will we continue to over-extend ourselves as far as infrastructural investments are concerned.

To bring about these changes, we must free ourselves from the limitations of the administrative system and separate government from enterprises so that banks (including the central bank and all specialized banks) become genuine independent financial institutions no longer subordinate to the various levels of government. The central bank will be responsible only to the People's Bank and subject to the oversight of its standing committee; it will not take orders from any administrative head. Depending on real economic needs, the central bank is to set up branches coinciding with the economic regions. Between the bank and its branches there will be a vertical chain of command; subordination to local party or government machinery will be severed. Only thus can we wrest the financial system from the grip of the old fund supply system and put an end once and for all to the practice whereby bank credit eats from the "big rice pot" of currency issue.

As far as investments in infrastructural projects are concerned, the State Planning Commission should concern itself with long-range planning, not specific projects. The job of the Ministry of Finance is to allocate infrastructural development funds to the Construction Bank each year. It is up to the latter to work out the details of each project in the light of the State Planning Commission's long-range plan and on the basis of extensive and thorough scientific and economic studies. The Construction Bank should exercise its investment power independently and invite contractors to bid on projects. It should assume risks and economic responsibility and become a high-standard investment bank.

The various specialized banks should become ordinary state-run enterprises, operate independently, assume responsibility for their own balance sheets, shed their character as state banks, and no longer issue currency. They must make loans out of their own funds and deposits and balance their accounts. When the demand for loans increases and the banks do not have sufficient funds to meet the demand, they may apply to the central bank for credit. The central bank should regard specialized banks as its clients; their relationship should be one of trust between depositors and lenders. The central bank assumes no responsibility whatsoever for the balance of funds at specialized banks or for the state of their business. As independent financial institutions, specialized banks should assume all risks arising from the loans they make. When their loans turn sour or cannot be recovered, they must declare bankruptcy and close down, while honoring all legal economic obligations.

The advantage of this approach is that it completely does away with the old system in which bank credit eats from the "big rice pot" of currency issue, and creates conditions for the separate management of bank credit and currency issue. It also alters fundamentally the subordination of specialized banks to local governments so that banks can now become genuine commercial banks and not fund-supplying arms of the various levels of local authorities, thus paving the way for the use of economic tools by the central bank to control the extent of credit.

12581

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## FINANCE AND BANKING

### SENIOR BANK OFFICIAL ON FINANCIAL REFORM

Beijing LIAOWANG [OUTLOOK] in Chinese No 39, 29 Sep 86 pp 9-10

[Interview with Liu Hongru, vice president of the People's Bank of China, by LIAOWANG reporter Zhu Minzhi [2612 2404 0037]: "We Must Push Ahead with Financial Reform"; date and place of interview not given]

[Text] This reporter recently interviewed Vice President Liu Hongru [0491 7703 0320] of the People's Bank of China, who is also vice chairman of its board of directors. In his answers to the reporter's questions, sprinkled with many novel ideas, the economist analyzed China's financial situation and discussed reforms in the works.

Liu Hongru studied economics at Moscow University in the 1950's and obtained a doctorate. He has been in financial work for more than 3 decades and is familiar with the financial systems in the Soviet Union and Eastern Europe. He also has an extensive knowledge of financial systems in the West. He is a driving force behind financial reform in China both in theory and in practice.

#### The Progress and Problems of Reform

Liu Hongru said that financial reform in China began in 1979 in the wake of the development of a commodity economy. At the beginning, reform took the form of broadening the scope of credit activities and changing fund management methods. The scope of lending was enlarged and eligibility for loans was relaxed. In the past, there was only one form of bank credit; now commercial credit and consumer credit are offered on a trial basis. The foreign exchange control system too has been reformed and foreign financial transactions have been on the rise. Domestically, the insurance industry was revived and an economic compensation system was instituted. Turning to financial institutions, four specialized banks were established in succession, as well as a host of trust and investment companies, credit cooperatives, and other financial institutions. Also created was a central bank system, with the People's Bank of China discharging the special functions of a central bank, exercising leadership over and managing the financial affairs of the entire nation. In Liu Hongru's opinion, these reforms have been instrumental in vitalizing the financial sector and the economy, promoting economic development, and opening China to the world.

At present China's financial system still faces many problems. First, ineffective macroeconomic regulation and control. Deregulation tends to lead to a loss of control, while restrictions and controls are likely to make the entire system "uniformly" rigid. Second, the vertical allocation of funds is not compatible with the development of horizontal economic linkages. Third, the use of capital has produced very poor results. The fund supply system whereby banks channel capital to enterprises has by and large remained unchanged. Economic regulatory measures have proved ineffective as tools of restraint. Fourth, the commercialization of financial institutions has not been realized. Financial institutions lack internal dynamism and vitality and it is hard to improve their business efficiency or the quality of their services.

#### A Reform Outline for the Seventh 5-Year Plan

Asked about the demands on and general goals of financial reform during the Seventh 5-Year Plan, Liu Hongru pointed out emphatically that financial reform in the Seventh 5-Year Plan occupies an important place in the overall restructuring of the economic system. This is because we are engaged in a gradual process to shift the Chinese economy from a model that emphasizes the management of tangibles and direct control to one that emphasizes the management of value and indirect control. And finance is one of the most crucial and effective instruments of indirect control. Hence the critical role it will certainly play in the development of a socialist commodity economy. That is why the Seventh 5-Year Plan is a vital period in the development of China's financial sector.

Liu Hongru said that Premier Zhao Ziyang has recently issued new guidelines on financial reform and demanded that we speed up the pace of financial reform to adapt to the new situation characterized by economic growth and the restructuring of the economic system. Accordingly, after careful studies and research, the People's Bank of China has proposed a general tentative plan for a new financial system for the nation along with its goals. First, establish a flexible and multilevel macroeconomic regulatory and control system. Second, set up a multilevel, diversified credit system featuring a range of credit instruments to raise and regulate funds, besides the predominant form of credit, bank credit. Third, establish a socialist financial system with the central bank as the leader and a multitude of banks of all types as the main players. A variety of financial institutions will coexist in the system, performing different functions in a division of labor. Fourth, set up a modern management system for the financial institutions. Generally these four reform goals demand that the financial system adapt to the restructuring of the economic system and the development of a socialist commodity economy institutionally and in terms of policy so that it can really function as an economic lever.

#### Reforms in the Next 2 Years

What reforms are being planned for the next 2 years in accordance with the general demand on financial reform in the Seventh 5-Year Plan? What would be our focus? Liu Hongru was asked to discuss these aspects.

He said that financial reform requires us to do a lot of work; we must set priorities and carry them out step by step. The next 2 years will essentially be devoted to the beginnings of a funds market, the commercialization of specialized banks, and the improvement of the macroeconomic regulatory and control system in order to generate more momentum for financial reform.

Liu Hongru expressed his views on further improving the macroeconomic regulatory and control system in the next couple of years. He said, "Macroeconomic regulation and control by the central bank is the pillar of the macroeconomic management of the financial system. Macroeconomic regulation and control includes the goals of monetary policy, medium-range goals, and the use of regulatory mechanisms. In the last 2 years, we adopted a number of measures intended to bring about a change. That is, the central bank has abandoned its preoccupation with controlling cash in favor of a dual concern--controlling the money supply and the total extent of lending. The reason was to effect a gradual shift toward a system of indirect financial regulation where only the money supply will come under control. Henceforth, the central bank will no longer satisfy the fund requirements of various specialized banks. It is up to the latter to attract as much funds as possible on their own. Lending by the central bank to specialized banks constitutes an important avenue of loosening or tightening the money supply. Because the Chinese funds market is still in its infancy and financial macroeconomic regulatory mechanisms have not yet begun to function properly, administrative tools cannot but continue to play a role in macroeconomic regulation in the near future. Meanwhile, as commercial notes become popular and proliferate, the proportion of rediscounted money supply will go up steadily. Moreover, in the wake of the rise and growth of the financial market, operations on the open market will gradually flourish and take up a major place in the central bank's regulatory and control system."

Liu Hongru then went on to suggest that interest rates must be further adjusted in the near future. He said, "After preliminary reforms, the interest rate system has begun to regulate the supply and demand of funds. Last year, interest rates on savings accounts were raised twice, which did much to boost savings tremendously for a prolonged period and broaden the sources of funds. Nevertheless, China's current interest rates remain low and therefore have not been an effective economic lever; we have so far failed to make the most of interest rates to regulate the capital structure and industrial structure. Conditions do not yet exist for easing interest rates soon. We must relate the adjustment of interest rates to price changes and differentiate between different cases in our interest rate policies. For instance, discount rates between banks have been deregulated. Rediscount rates are slightly lower than interest rates on circulating-fund loans. Economic zones, areas with a developed commodity economy, and collective financial institutions should be given greater autonomy to adjust interest rates. In the future, as the commodity market is put on a sound footing, interest rates must be deregulated to a greater extent, while retaining control in a small number of cases. An interest rate system must be established where the rediscount rates of the central bank would be regarded as the standard in order to make full use of interest rates in regulating the money supply."

Liu Hongru also discussed future plans to reform financial institutions by commercializing them. On the one hand, the several major specialized banks now existing must be energized. On the other hand, efforts must be made to develop and build up a host of financial institutions to meet economic development needs. As far as state-run specialized banks are concerned, the thrust of reform is to end their monopolistic status. All financial institutions must seek to expand their operations through competition so that step by step they are run like a business.

Liu Hongru said that the foreign exchange control system must also be reformed in the next 2 years. Our drive to strengthen control over foreign exchange and foreign debts is mainly prompted by a desire to inject life into exchange rates and foreign exchange gradually through the use of market mechanisms and under the guidance of the national plan. We propose to nurture export industries, promote foreign trade, import foreign capital, and support domestic development.

#### Establish A Financial Market Systematically

There is at present a strong public interest in the formation of a Chinese financial market. Liu Hongru has done some research on this issue and published a paper outlining his ideas. This reporter asked him to discuss the plans of the People's Bank of China concerning the formation of a financial market in the near future.

Liu Hongru noted that China's financial market is dominated by indirect fund circulation, that is, fund circulation between banks, and supplemented by direct fund circulation, that is, fund circulation between enterprises. Neither kind of circulation can be separated from the financial market. The financial market is an essential condition for the establishment of a sound commodity market and the cornerstone of financial macroeconomic regulation. One of the priorities of financial reform at the moment is to open up a short-term fund market.

How do we really set up a financial market with Chinese characteristics, taking realities as our starting point? And what kind of financial market can we go about putting together right now? Liu Hongru thinks this is a complex issue that has to be studied and explored further. One of the things we can do now is to develop a discount market between banks and other financial institutions. We must push for the formation of a discount market between banks, a notes market, and a short-term bonds market shortly. Today seven urban centers such as Wuhan, Shanghai, Shenyang, and Guangzhou, have already created a rudimentary discount market. A note exchange center which is based on cities has also been set up as an experiment. All this has been highly successful in accelerating fund circulation and increasing the efficiency of fund utilization. Another thing we can do is to set up a note discount market. In the future, we should vigorously develop commercial notes and bank notes in order to translate commercial credit and bank credit into notes. From now on specialized banks will develop the discount business in a big way, while the central bank will go into rediscount services so that fund transfers between financial institutions, between banks and enterprises, and between



enterprises will be based on notes and that discount and rediscount notes and mortgaged loans become the major forms of loans. In addition, efforts will be made to set up a secondary market, and hence a notes market, on a trial basis to promote the circulation and transfer of notes.

Liu Hongru said that we should take a gradual exploratory approach toward the formation of a long-term financial market. For some time to come, our emphasis will be to steer capital raising activities onto the right track, so that these activities will take the form of trading in stocks and bonds. The market will also be managed in accordance with the law. In other words, banks, trust and investment companies, and financial institutions, acting as agents for enterprises, will issue bonds and stocks, thereby solving their fund availability problems. Transfer will also be effected through financial institutions. We will try all this out in experiments. Once we have the experience, we will then consider how to open up a secondary market.

At the end of the conversation, Liu Hongru told the reporter that the Seventh 5-Year Plan poses a herculean task for financial work and that we will do our utmost to raise funds and use them properly to good effect in order to create a favorable environment for the restructuring of the economic system and ensure smooth economic growth during the Seventh 5-Year Plan.

12581

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FOREIGN TRADE AND INVESTMENT

CHINA TO BALANCE FOREIGN EXCHANGE IN 5 YEARS

Hong Kong MING PAO in Chinese 24 Jul 86 p 34

[Report of an interview with Chu Baotai [0443 0202 3141] by own correspondent Zuo Shaozhen [1563 1421 3791]: "Gradual Reduction in China's Foreign Exchange Deficit--Balance Expected to be Achieved in 5 Years"]

[Text] Yesterday morning, before leaving Hong Kong, Chu Baotai, deputy director of the Foreign Investment Administration in the Chinese Ministry of Foreign Economic Relations and Trade, received our correspondent for an interview, during which he stated: As China has been importing foreign capital, it is only a natural phenomenon that a foreign exchange deficit should occur in the early years. Following the replacement of imported items by national products, there will be an improvement in the foreign exchange deficit situation. He estimated that if China can achieve a foreign exchange balance in 5 years, this would already be very ideal. The following is the interview in detail:

Question by correspondent: After a review of the report on the investigation of enterprises with foreign investments in 19 main provinces and municipalities carried out last year, are the central authorities considering an adjustment in policies and methods regarding the importation of foreign capital? For the future importation of foreign capital, will there be new arrangements in the overall plan?

Answer by deputy director Chu: Effective this year, China has certain new plans with regard to the importation of foreign capital. For instance, in January, China promulgated the "Regulations on Foreign Exchange Balances of Chinese-Foreign Joint Ventures," to provide new measures of assistance that will help resolve problems encountered by foreign-capitalized enterprises in balancing their foreign exchange. These regulations allow a method whereby the enterprises may solve the problem of balancing foreign exchange internally within a group by forming holding companies. This is a new experiment that is being tried out.

The central authorities have furthermore decided to make preparations to extend credit, in either RMB or in foreign currencies, during the latter half of this year to Chinese-foreign joint venture enterprises that have actually been established or for which contract negotiations have been concluded,

particularly to those engaged in exports. Although the central authorities have at present no intention to make new arrangements in the plans for the importation of foreign capital, there will be a large reduction for certain enterprises with foreign investments which rely very heavily on the importation of parts and components for their assembly-line production.

Q: Some criticize China for not having an importation program that conforms to its national conditions and that is rational, as a result of which China, after importing foreign capital, is again losing large amounts of foreign exchange. Criticized is also the fact that no distinction is made between projects of longer or shorter recovery times, which causes a lack of coordination between large, medium, and small-scale projects, and causes a serious shortage in foreign exchange funds.

A: Since opening up to the outside world in 1979, the central authorities have had annual programs for the importation of foreign capital, giving priority to the importation and encouragement of that kind of investments, that is quite clear. However, since the reform of the economic system is in progress, it might have been possible that with the downward delegation of authorities certain joint venture enterprises have been locally allowed to be brought in, which, from the viewpoint of national interest, are inappropriate. For instance, a large flood of projects several years ago of electronics assembly lines and taxicab enterprises were actually departures from the original plan. Since China is a country that practices planned economy, the duplicative importations that have occurred in certain localities were mainly due to problems in the macroeconomic regulation. The central authorities have by now strengthened controls and made it quite clear that the local authorities have no further authority to check and approve enterprises concerned with taxicab operations, or production lines for the manufacture or assembly of color TVs, tape recorders, and other such products, lines of business enterprises which the central authorities themselves will control directly.

Foreign-Capitalized Enterprises Have Few Problems. Foreign Investment Administration To Assist in Resolving Difficulties; Losses Due to Termination of Business Operations To Be Borne by Both the Chinese and the Foreign Party

Q: Judging from statistical data, the amount of foreign capital brought in by China during the last 7 years is considerable. However, that is not saying that the importation of foreign capital has already been a success. What problems are indicated by deficits that have occurred in the foreign exchange receipts and payments of foreign-capitalized enterprises? Apart from the case of Qinghai Province, which had a foreign exchange surplus of \$30,000, there are deficits in all the other 18 provinces and municipalities; why is there this serious situation?

A: China's purpose in bringing in foreign capital was the hoped-for importation of new products and technologies, particularly technologies of a crucial nature as pertaining to the technology-intensive industries of machine building and electronics. Basically, China has attained this objective, but

in the first years of importations, it could not be expected to have immediately exportation of products from these industries and an earning of foreign exchange. A rather extended period of time is needed until the imported technologies ripen and the intended transformations are achieved. The present imbalance in the foreign exchange situation is a natural phenomenon, and the foreign exchange deficit must not be taken as a sign that China's importation of foreign capital was unsuccessful. One example was the Beijing Jeep Company, where it was doubtful in the beginning of production whether the products could be exported, because of a price problem. However, with a continuous improvement in domestic production of items formerly imported, it was possible to gradually raise the competitiveness of the motor vehicles for sales abroad. Because Qinghai Province imported comparatively few projects, they had a surplus of \$30,000, while Fujian and Guangdong imported a comparatively large number of projects and had much more opportunity to use foreign exchange for imports. I believe things will get much better this year compared with last year.

Q: How will things turn better? Will there be a balance or surplus of foreign exchange?

A: We certainly cannot reach the stage of complete balance this year. It will simply be that the deficit will not be as serious as last year. If we can reach a stage of balance in 5 years, I would consider this a very fast development.

Q: When foreign-capitalized enterprises in Guangdong Province ran up a foreign exchange deficit of \$280 million last year, it was a situation that was felt by people to be a cause for anxiety. May I ask, to what extent the Shenzhen special economic zone shared in the deficit? And when could a balance possibly be achieved in the foreign exchange receipts and expenditures of the foreign-capitalized enterprises in the province of Guangdong?

A: I cannot right away list the specific figures for Shenzhen's share, but do not believe the share can be very large, but for Shekou the balance is a positive one. There will be an improvement in the foreign exchange deficit situation of Guangdong, but I really find it impossible to forecast when a balance will be achieved.

Q: Many foreign-capitalized enterprises are now one after the other starting up operations and now beginning to pay back the interest of foreign loans. If in these localities excessive investments have occurred in specific projects, as, for instance, in projects of the tourism industry, and difficulties should arise in operations and repayments, how will the Chinese authorities concerned handle the problem?

A: In my opinion only few foreign-capitalized enterprises will have problems, and the Foreign Investment Administration will cooperate in the resolution of difficulties according to state policy and legal provisions. Although excessive supplies are presently being made for restaurants and office buildings in Guangzhou, the situation there is still better than in the

Shenzhen SEZ. If difficulties should truly arise in the operation of the relevant enterprises, their business operations could be terminated, in which case losses will have to be borne by both the Chinese and the foreign parties.

Q: Have there presently been cases where the business operations of enterprises with foreign investment have been terminated? If the foreign loans involved had been guaranteed by China, how would such cases be handled?

A: There have been such cases, for instance, the Quanzhou Foodstuffs Plant in Fujian and the Chunhua Fashionable Dress Factory in Guiyang. The former was participated in by Singapore businessmen, and the latter by Hong Kong businessmen. Both were terminated because they had made inaccurate market forecasts and their products could not be marketed. Since there had been no question of loans in foreign currencies in the projects concerned, the general losses on liquidation were borne by both sides.

Q: Foreign capital is extremely concerned about the Chinese Government's intention and suggestion to abolish the foreign exchange certificates. Is the Foreign Investment Administration aware of their state of concern?

A: We are of course aware. Among them the restaurant and taxicab enterprises are extremely worried about the suggestion to abolish the foreign currency certificates, because from that day on these particular enterprises will face a crucial problem when taking in RMB, as to how to account and how to convert their receipts to foreign exchange. The others are the enterprises with foreign investments that export their products, and there is no problem in their cases. The state and the departments concerned are now studying these problems, and it is at present not yet clear what the situation is.

9808

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FOREIGN TRADE AND INVESTMENT

SHANGHAI EXPANDS BARTER TRADE WITH EASTERN EUROPE

Shanghai WENHUI BAO in Chinese 3 Oct 86 p 1

[Article by Zhu Guangning [2612 0342 2494] and Ye Ren [0673 0086]: "Shanghai's Barter Trade with Eastern Europe Makes Good Progress; Shanghai Goods Are Well Received; This Trade Has Now Expanded To Include 20-Some Goods"]

[Text] Shanghai's local barter trade with Eastern European countries is off to a good start. In the short 2-plus years since this channel of trade was established, both sides have exchanged, on the basis of equality and mutual benefit, goods they have for goods they need and expressed great interest in expanding economic and trade relations. The number of goods involved in this trade has grown to more than 20, including machine tools, woolens, instruments, meters, clothing, construction machinery, shoes, knitwear and refrigerators.

Socialist Eastern European countries have a combined population of 1 billion and a solid economic and technological foundation and thus cannot be overlooked in international trade. This region has been a traditional market for Chinese textiles and light industrial goods and during the 1950s accounted for a substantial share of Shanghai's exports. And even though demand for and expectations regarding the quality of imports has recently increased in these countries, "Shanghai goods," which are excellent in quality, rich in variety and novel in design are still popular among local consumers. These countries boast an almost complete range of industry, their industrial technology generally ranks from the top to the middle of world levels and these countries possess considerable advantage in a number of areas. Much of this region's advanced technology is well suited to Shanghai's program to upgrade technology and equipment, and thus there is great potential for the expansion of economic relations and trade between the municipality and the region.

Beginning in the second half of 1984, Shanghai initiated local barter trade with Eastern European countries outside of national government agreements, and the Shanghai Foreign Trade Corporation organized trade and economic cooperation in a unified fashion. Expansion of this trade was greatly facilitated by the use of a system of open accounts, the balance maintained between imports and exports and the fact that the two sides did not have to make payments in hard currency. Progress was achieved on the first visit of Shanghai's local barter trade delegation to the GDR, Hungary, Poland,

Czechoslovakia and other countries in Eastern Europe, so a number of contracts were signed when the delegation returned home. Yugoslavia, Hungary, Poland and other Eastern European countries have actively participated in or operated their own trade exhibitions in Shanghai, introducing their products and increasing Shanghai's understanding of those countries. And a number of Eastern European economic and trade officials and company and enterprise leaders have come to Shanghai on numerous occasions to visit and discuss trade and economic cooperation.

The transits, levels, mold machinery, pop-bottle filling machinery imported from the GDR; the steel boring machinery and cement mixers imported from Czechoslovakia; the woolens imported from Poland; the LAIHAIER [brand name] refrigerators imported from Hungary; and the like have been especially well received by Shanghai end-users and consumers. And the shirts, corduroy, knitwear, shoes and the like that Shanghai exports are very hot items on Eastern European markets.

12431

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FOREIGN TRADE AND INVESTMENT

SHANGHAI DEFENSE INDUSTRY INCREASES CIVILIAN-GOODS EXPORTS

Beijing GUOJI SHANGBAO in Chinese 22 Sep 86 p 2

[Article: "Shanghai's Defense-Industry Enterprises Obtain Outstanding Results Exporting Civilian Goods"]

[Text] In recent years, Shanghai's defense-industry enterprises, in their efforts to expand production of civilian goods, have vigorously increased exports thereof, earning nearly \$700 million in foreign exchange during the Sixth 5-Year Plan. Included among these exports were 641,500 metric tons of ships, or 80 percent of the total tonnage exported nationally, which earned \$596.74 million, or 60 percent of the nation's total.

One reason why Shanghai's defense-industry enterprises have been able to increase exports is their ability to develop technology. In recent years, these enterprises have made good use of their specialized skills in defense industry to develop, in accordance with demand on international markets, a number of exports, consisting largely of ships, aircraft components, machinery and electronic goods, for which a large market exists. For example, Shanghai Plant No 573 combined defense-industry technology with imported technology to develop for export electric shears, automatic fabric testers, combination TV cameras and the like in little more than a year, and earned more than \$4 million in foreign exchange therefrom before the end of the second year. A second reason why Shanghai's defense-industry enterprises have been able to increase exports is that their exports earn much foreign exchange. For example, the main and front landing-gear doors Shanghai exports to the United States are excellent in quality, and thus the United States decided to allow China to use those doors to equip all aircraft exported to China. Consequently, orders for those doors increased by one fold this year, and the doors earn more than \$1.3 million annually. A third factor behind the rise in exports is that Shanghai's defense-industry enterprises continually readjust their product mix, reduce the number of low-grade goods produced, initiate production of high-grade goods and have progressively transformed themselves from extensive to technologically intensive industries. These enterprises now possess a number of new technologies that can be used to produce new products such as new types of ships, automobiles, robots, intelligent instruments, satellite ground receiving stations, radio and TV transmitters and receiving installations and the like.

12431  
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## CONSIDERATIONS FOR PROMOTING SHANGHAI'S EXPORT TRADE

Shanghai CAIJING YANJIU [THE STUDY OF FINANCE AND ECONOMICS] No 5, 3 May 86  
pp 21-24

[Article by Jin Weizu [6855 1983 4371] and Min Yi [7036 3015]: "Strategic Concepts for the Promotion of Shanghai's Export Trade"]

[Text] For several years past, Shanghai has not been able to effect any major breakthroughs in its exports. Objectively, this has adversely affected the overall development of Shanghai's economy and has weakened the competitive position of Shanghai among China's ports and in the international market. According to statistics, in 1985 exports through Shanghai port amounted to \$3.377 billion, of which goods manufactured in Shanghai amounted to \$2.7 billion. Even though these figures overfulfilled that year's state plan, it meant a decline of 21.8 percent compared with the record export year of 1980. The question of how to promote Shanghai's export trade has, therefore, become urgent, as this question will have a direct effect on Shanghai's ability to accomplish the Seventh 5-Year Plan.

The unhealthy state of Shanghai's export trade is circumscribed by a variety of factors. Viewed in an international context, the repercussions of "stagflation" have not yet completely disappeared, market demand is not brisk, trade volume has shrunk, and protectionism has escalated. Add to this the fact that our products have remained unvaried for many years, not easily adapting, either in production or in distribution, to the changing demands of the international market, and in this way have lost competitiveness in the international market. Viewed in the domestic context, owing to a lack of a proper acknowledgment of the role of export trade for the future strategic position of Shanghai, not enough attention was paid to the international market, and no effective export policy and export measures were taken. It was, therefore, not possible to adapt effectively to the demands of the international market in organizing production and sources of export commodities, so that confusion frequently reigned in production and foreign trade operations. Viewed in the context of Shanghai's recent export commodities, there was a sharp decline in easily marketable goods. Such goods became increasingly in short supply and lost much of the export volume that they should by rights have gained.

Fundamentally, the problems that have surfaced in Shanghai's export trade are created by defects in the organizational system of foreign trade. Foreign trade is different from domestic trade in that it links two large markets, the domestic and the international. Furthermore, at the present stage there are distinct differences in these two large markets; the domestic market has not yet abandoned the business conditions of a "seller's market," while the international market is a veritable "buyer's market." To comply with the requirements of a "buyer's market," it is necessary to have a system of foreign trade administration that is suited to competing in the international market. However, it is common knowledge that no reform of the foreign trade system can proceed in isolation, but is conditioned by the reform of the entire national economic system. At the same time, the transformation and perfection of the foreign trade system itself requires time, a material base, and the gathering of experiences; it cannot be accomplished in one move. The purpose of the present article is to discuss tentatively, starting out from the prevailing realities of Shanghai, how to develop new strategic concepts for Shanghai's foreign trade, within the framework of the present system and concentrating on the advantages that Shanghai offers.

### 1. Strategy of Infiltrating Foreign Markets

To cope with the present situation, characterized by fierce competition in the international market, an excessively strong demand for commodities, shorter life cycle of products, and difficulty of forecasting factors of possible change, Shanghai's foreign trade must focus attention in fanning outward on "pushing forward," pursuing a strategy of market infiltration in the style of "intensive and meticulous farming," adopting the tactics of quiet entry, gaining firm footholds, proceeding steadily with well-directed thrusts, advancing gradually while entrenching at every step, and forming a trade network. In concrete terms, the following may be adopted as points of departure:

(1) Infiltration of Markets in Eastern Europe, the Soviet Union, the Middle East, Africa and Latin America; Development of "Barter Trade." With attention focused on the distinct environmental characteristics of the various national markets, a force must be assembled to launch key investigations, at the same time studying and taking a lesson from the successful experiences of other countries in their strategies of infiltrating markets, making useful for our purposes on a wide scale whatever others excel in, and seeking out "niches to be filled," which would allow "pushing" our goods into the markets concerned. Such action would offer us "gaps" through which our goods could penetrate those markets. Demands in the international market are demands at different levels from consumers of great diversity, of different categories, and of different strata. The developed countries mainly dominate markets with high-class, sophisticated, and top-notch products, so that there could possibly be "niches to be filled" in the markets for medium and low-grade goods of the labor-intensive variety. Experience has shown clearly that such "niches to be filled" in certain markets frequently leave full rein to the "foreign expansion" of countries and territories that are less favorably placed in international trade. Countries like the "four smaller ones" in Asia, Yugoslavia and Greece in Europe, and Brazil in South America are gaining "glorious victories" in "warring" on these precious grounds. Considering the

composition of goods that Shanghai can make available for export, Shanghai too must seek out and take advantage of market niches. Such areas as the Soviet Union, Eastern Europe, the Middle East, Africa, and Latin America are "demand-thirsty" countries, and the products of Shanghai, particularly certain products of the light and textile industries, such as children's clothes, thermos bottles, enamelware, common hardware, hand tools, and sewing machines have a broad market in these countries. The problem is that most of these countries belong to the Third World and lack capital funds, are debt-ridden with adverse balances of international payments, therefore hardly capable of any cash transactions. It is therefore crucial in the infiltration of the markets of these countries to devise such trading patterns that would be acceptable to both sides. We believe that barter would be a simple, direct, and feasible way. What is called barter refers primarily to the transaction of a commodity exchange without the use of currency by either side. It is truly the process of one country exchanging one or several kinds of commodities with another country according to a certain method of computing the values involved. Barter has the advantage that goods are exchanged against goods, surpluses and shortages are mutually balanced out, imports are combined with exports, an equilibrium is created between imports and exports, and foreign exchange is saved. Shanghai offers favorable conditions for the development of barter trade. Its advantages are considerable production capacity and an industrial structure and mix of industries which are fairly complete. Shanghai is, therefore, eminently capable of using barter trade to broaden its overseas contacts and for economic expansion abroad. On the one hand, through a variety of patterns of importing foreign capital, such as technology imports, compensation trade, leasing operations, joint ventures and cooperative enterprises, Shanghai can modernize its light and heavy industry and produce goods of high quality. Apart from a portion of such goods that can be directly used for resale by the state to the producers or for exports, a portion of the remainder, which would be free for domestic sales, could serve as one of the material bases for barter trade. On the other hand, Shanghai may obtain through barter trade such primary products of other countries, of which one part may be used to satisfy domestic demand, and one part to be processed into finished products and again exported. Moreover, one part may be set aside as items available for purchase by foreign investors, to help them balance their foreign exchange accounts. Two results could be obtained in this way: one is the expansion of exports and lightening the pressures caused by shortage of foreign exchange; the other is the acceleration of the use of foreign capital, the modernization of Shanghai's traditional industries, and, furthermore, the guidance of enterprises to gradually switch to an "outward orientation" in their business concepts.

(2) Developing Research in Market Business Operations and Marketing; Studying the Potential of the International Market and the "Market Share Targets." Any plan to expand into a new market must base on the results of investigation and research leading to an initial evaluation of the market potential in its present condition and with regard to developmental prospects. This entails:

A. An analysis of the present market demand. The starting points for the analysis of present market demand must be an understanding and grasp of the magnitude of real demand for our products in the present market, a careful distinction of separate "saturation points" in each market, and ascertaining whether the prices of our goods are favorable in comparison with those of the

competitors. It is on this basis that the operational tactics for an entry into the market will have to be drawn up. B. An analysis of the trend in market demand. Through first or secondhand data, it is necessary to assess the prospective market trends, especially to give close attention to business trends of multinational corporations, so as to gain by analysis the position and potential of our products in future markets, and on that basis determine long-term strategic tactics of "foreign expansion." C. Analysis of the markets, separate by countries, and a detailed subdivided analysis of market characteristics. The study must not only deal with the factors of politics, socioeconomics, culture and customs, but should nowadays particularly strengthen studies of customs tariffs, quotas, and protectionism, because these factors seriously affect the export and trading conditions of Third World countries and weaken the competitiveness of their products. D. "Market share targets" should be fixed for the products that are available for export according to the areas involved and in accordance with rational expectations. Setting unrealistic market share targets would be extremely harmful. Superficially, it would seem preferable to set market share targets at as high as possible a level to give the impression of a high economic strength of the enterprises concerned, but in actual fact, high market shares that could only be obtained by competing with cheap prices will not only be impossible to maintain for any length of time, but may also weaken the economic strength of the enterprises concerned and be regarded as dumping by the importing countries. When considering market shares it is, therefore, necessary to give up subjective illusions and shun unprofitable business operations and irrational expansions, and instead adopt purposeful "market share targets" that conform to reality and comprise all such factors as balanced investment income and long-term business interests.

(3) Research and Development of New Products; Raising Competitiveness of Products. During the last decades, as the commodity war in the international market rapidly intensified, developed countries, as Japan, the FRG, and the United States, were universally concerned about the development of new products, investing huge sums, as much as \$1 billion per year, in research and development. China's corresponding investments, in comparison, are next to nothing. To support the development of new export goods by energetic action is in the case of Shanghai a matter that brooks no further delay. The purpose of research and development of new products is to comply with market requirements, to avoid obsolescence of products, to enhance competitiveness of enterprises, and to open up new markets. Whatever form the new products will assume, as long as they are novel, useful, and competitive, they will easily be accepted by the market. The term novelty mainly refers to export products which in design and manufacture combine, aimed particularly at the international market, a compliance with the trends of the time, special traditional features, as well as creative ideas. As to usefulness, this refers to the necessity that the design must meet the needs of different markets and of different consumer groups; to be easily marketable, the goods must not be a single color, like a "complete suit" in a mahjong game, or of monotonous design. As to competitiveness, it means that the price and utility value of the products must be favorable compared to those of similar products of the competitors. The development of new products is a complex as well as risky undertaking. It requires large amounts of capital and technological capacities and cannot be accomplished without support of state

policies. We believe that the departments concerned together with the export enterprises should organize "innovation teams," to draw up a strategy for the development of new products. The government should render cooperation in its policies, for instance, exempt new export products from domestic taxation, raise the share of foreign exchange that enterprises may retain from exports of new products, establish a fund for development of new products, grant subsidies where losses are incurred in development of new products, have banks grant low interest loans for development of new products, etc. This would induce the entire society to show concern about development of new products, and would bring about the transition of our new export production from a "guided-development pattern" to a "self-determined developmental pattern." It is worthwhile noting that in the process of developing new products, we must under no circumstances neglect the role of the process of trading in and marketing the new products in the development of new products. Many new products show appreciable distinctive features all the way from conception to manufacture, but will finally not be accepted by the market for the basic reason that attention was merely paid to the development stage of the new product per se, while neglecting the market development stage. Every new product constitutes the entry of a product into a new life cycle. If people are to have knowledge of it, and, furthermore, to develop interest and a liking for it, the consumers must be informed of its functional qualities and special features through the medium of advertising. In the past, advertising of China's export goods was very insufficient; this marketing tool was not fully utilized in the service of product development. In future, the fullest use must be made of foreign newspapers and periodicals, outdoor advertising, introduction of samples, and publicity through foreign advertising agencies. Moreover, the foreign trade departments must also without delay do an effective job of "follow-up investigations" after the products have been put on the market, so that the export commodities can be introduced into the international market with a well-defined objective in view.

(4) Operating in "Associated Groups" in the International Market. As China transacts foreign trade as a socialist country, it stands to reason that it would adopt a unified stand in dealings with the outside world. However, actual conditions are not at all like this. The fact that some of Shanghai's products cannot be profitably sold on the international market is not due to external factors, but due to the "low price challenges" by certain other Chinese ports. As a result, Shanghai products lose their competitive price advantage. The losses caused by such "internal waste of efforts" are extremely deplorable. It must be realized that attempts to counter the multinational corporations, which occupy so powerful a position in the setup of the international market, by dispersed operations through a multitude of exporters and by competing by lowering prices will only result in tying ourselves up hands and feet and throwing away our advantages. The only way to mend the state of "internal waste of efforts" is to combine the many heads into one, to transform the desultory and blind expansion of exports into a planned and well-defined export activity, having export commodities handled by "associated groups," that is, to establish uniformly fixed export prices for the same commodities at all Chinese ports, while conducting exports separately in a division of labor. It is furthermore necessary to set up an organ for "common relations in international trade" at the major trading areas, to coordinate relations between various parties and to transmit feedback on

recent changes and trends in the market to domestic enterprises. Should a case of uncoordinated action then occur at any port, a warning should be issued, this to reduce the possibility of indiscriminate exports and to avoid inflicting ruin on one another.

## 2. Adopting Domestically a "Eureka" [European Research Coordination Agency] Plan as Shanghai's Export Commodity Strategy

If we are to achieve an upswing in Shanghai's foreign trade and to compete in the international market, it is necessary to not only institute a strategy for market infiltration directed toward the outside world, but to adapt our internal environment to our "objectives of foreign expansion." Adopting a "Eureka" plan as Shanghai's export commodity strategy means to concentrate the strength of all of Shanghai's sectors into one large combined organization, comprising the production and circulation aspects of foreign trade and its related fields of industry, agriculture, finance, banking, material resources, customs, and the various specialized corporations. Moreover, according to the internal relationships that inevitably exists between them, bring into being a production and circulation network system in the form of economic linkages, that has foreign trade as its core, is a crisscross of vertical and horizontal relations, and is three-dimensional and comprehensive. This plan is composed of the following subsidiary plans:

(1) A Plan Pattern Determining Shanghai's Export Commodity Strategy for the Seventh 5-Year Plan. As demanded by the central authorities, two great strategic changes have to be made speedily with regard to Shanghai's export commodities. One is the shift in export commodities from primary products to finished products, and the other is the shift from exporting roughly finished to exporting highly finished products. While Shanghai should continue to tap existing potential and expand exports of products of the light and textile industries, Shanghai must also fully exploit its advantages in science and technology and managerial skills, and place emphasis on the significance of its machine-building capability, explore further export possibilities for its machinery and electrical products, and effect a basic improvement in the composition of Shanghai's export commodities. There is no doubt about it that the proportion of machinery and electrical products in a country's exports indicates the level of industrialization of the country. Many developing countries are making expansion of machinery and electrical products exports the major means of attaining an upswing in their national economies, and they place special emphasis on the development of these exports, regarding them as strategic undertakings. Shanghai has a solid industrial foundation and manufactures many items of machinery and electrical products, such as grinding machines, punching machines, electric tools and standard parts, which all have found a certain market abroad. Sales of these items should be further developed. Expansion of machinery and electrical products exports must be the direction in which Shanghai is to change the composition of its export commodities. This will radically change the unsteady state of its foreign trade, which has prevailed for a long time. Gradually, an export commodity echelon shall be formed in which machinery and electric products will be primary items, but in combination with the products of the light and textile industries and labor services, in a tremendous effort to achieve, with the larger proportion of machinery and electrical products, a conspicuous

breakthrough during the Seventh 5-Year Plan. To accomplish the great shift in the composition of export commodities, it is necessary that the engineering-trade and technology-trade departments wholeheartedly cooperate, forming a kind of "centripetal force." The foreign trade departments must judge the hour and size up the situation, must excel at transmitting information feedback, and help the export enterprises in grading control of their products (A-grade to indicate products currently in great demand; B-grade to indicate products in a period of full maturity; C-grade to indicate products for which there is a potential demand; D-grade to indicate products to be eliminated). They should, furthermore, determine different business and sales policies depending on the various grades of the products, and thereby guide the enterprises to keep the market in mind as the target for all their business operations and to determine production according to demand.

(2) A Plan for an Integration of Foreign Trade, Science and Technology, and Production. As demanded by Shanghai's "export orientation," the various departments shall be tied together by economic and legal means to form a chainlike horizontal transfer system. The internal structure of this system is to be a compact and relatively independent entity. The system shall be in direct face-to-face contact with the international market. The foreign trade departments are of course the leading element in this system. They have to have a grasp of the direction of market demand, have to promptly transmit feedback of the latest market information to the domestic science and technology departments and production departments, who will then combine efforts to tackle key problems, with the cooperation of the materials, finance, banking, and various functional departments, so that the products will be introduced into the international commodity market within the shortest possible time. Execution of this strategy of integration will in future be beneficial not only for the linkage of industry with trade, technology with trade, and the linkage between departments, but, more importantly, for the initial formation of the benign cycle of "pushing into the outside world" and "establishing cooperation with units in the interior." The decisive criterion for success or failure of the integrative plan is the economic benefits that enterprises will be able to gain. With regard to the present practice of granting a bonus of 3 fen for each dollar of planned exports and 20 fen of profits allowed to be retained for each dollar of unplanned exports, and with regard to the 12.5 percent of foreign exchange which the enterprises are allowed to retain, enterprises shall be allowed, according to varying needs, either to set up foreign exchange accounts at the Bank of China, or exchange these funds for RMB at a more favorable exchange rate and have these funds flexibly available for use, so that enterprises that create foreign exchange will truly have authority of disposition with regard to these funds. At the same time, a restricted market for the adjustment of demand and supply of foreign exchange among the enterprises may be instituted, allowing the enterprises to mutually regulate among themselves the foreign exchange which they are allowed to retain. In this manner, it will, on the one hand, be possible to strengthen economic relations and exchanges of information between export enterprises, and, on the other hand, to increase the vitality of the entire system.

(3) A Plan to Arrange Multichannel Sources of Export Commodities. With regard to the establishment of sources for export commodities, there are, in

the case of the port of Shanghai, three ways of expanding such sources: one is to strive to establish sources in the interior; a second is to employ a method of substitution, that is, to gradually substitute products from outside for Shanghai products, and have Shanghai products upgraded and updated to achieve larger exports; a third is to establish sources abroad, spend small amounts of foreign exchange to bring in goods, and engage in "importing materials for processing," the processed goods then again to be later exported. Judging by actual conditions, the first method may after all be regarded as the best plan. To evolve a way of establishing sources of commodities under the conditions of expected general price increases in the interior is a responsibility of both industry and trade. In addition to the increased use of methods of procurement and agency arrangements, Shanghai must still energetically continue joint operations, joint ventures, and purchase authorizations to strengthen its connections with the interior and to ensure the supply of export goods.

(4) A Plan of Indirect System Controls and Regulations in Support of Exports. Economic levers play a powerful role in economic life as restrictive elements. By external conditioning they can restrict the direction of industrial development, and using them in the right way, twice the results can be achieved with half the effort. Conversely, their inappropriate use will bring no end of troublesome consequences. Looking at the tax aspect, taxes directly affect costs and restrict prices. At present, taxation still does not sufficiently function as an encouragement for exports. The setup of the various taxes on foreign trade is not altogether rational. The tax portion in export commodity costs is excessively high and adversely affects product competitiveness. We believe that taxation of export commodities should be mainly regulatory, they should be taxed only lightly, and the development of taxation should be directed toward allowing the formation of rational and appropriate prices, toward arriving at a fair tax burden, toward an adjustment of the tax structure, and toward encouragement of exports. Looking at the loan aspect, loans restrict the improvement of the scope and composition of export commodities. To bring about a change in the present condition of loans only insufficiently supporting foreign trade, and to avoid that domestic stringency of funds, which combined with an arbitrary uniformity of action, might have adverse effects, it is suggested to establish a foreign trade bank, which would specially be charged with providing export loans, and would grant loans at favorable conditions to specialized export factories. Regarding the problem of exchange rates, they should by rights reflect changing conditions of domestic and international market prices, and determination of actual exchange rates must give full consideration to the international balance of payments and ensure that most export commodities yield profits. Judging by current exchange rates, there is a need for a further downward drift. All other economic levers, such as pricing, export subsidies, cost of exchange remittances, should be revised in varying degrees. To sum up, the effective and comprehensive control and adjustment of the system will be helpful toward realization of the demand for "pushing into the outside world," will facilitate a unified stand toward the outside world, and will ensure coordination of economic relationships.

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## FOREIGN TRADE AND INVESTMENT

### IMPORT TECHNOLOGY THAT HELPS CHINA BECOME SELF-SUFFICIENT

Shanghai SHANGHAI JINGJI [SHANGHAI'S ECONOMY] in Chinese No 3, 31 May 86  
pp 33-34

[Article by Yu Nan [3022 2809]: "Domestic Production of Parts for Imported Technology Must Be Increased"]

[Text] In order to increase our self-reliance, improve scientific and technical levels, and hasten the realization of the four modernizations, we must have a planned, focused and selective introduction of advanced, appropriate foreign technology. At the same time, we must increase the domestic production of accessory parts for that imported technology.

#### I. The Urgency of Domestic Production of Accessory Parts for Imported Technology

In recent years China has imported production lines for color television sets, home refrigerators, washing machines, automobiles, and other high-grade consumer goods; this has had a positive effect on meeting market demand, enriching the people's lives, withdrawing currency from circulation, and improving industrial production technology. But these products are generally developed inversely from final products, and their accessory component parts, spare parts, structural elements and raw materials all must be developed. But in recent years there has been greater emphasis on importing production lines, with inadequate consideration given to the domestic production parts; progress in domestic production has not kept up with the increasing imports of production lines. For this reason most parts must still be imported, to the extent that the foreign exchange expended on maintaining production-line output is greater than the amount used to bring in the production lines themselves, and in some cases much greater. For example, the Shanghai No 1 Television Factory spent approximately \$11.42 million in foreign exchange to import a production line, and last year alone the accessory components imported amounted to \$49 million. Four Shanghai refrigerator factories spent a total of \$19.35 million in foreign exchange to import production lines, producing 355,000 sets this year, but they spent 20,025,000 to import parts. Shanghai's "Santana" automobile requires an average of \$6,500 in imported parts each; with an annual production of 30,000 vehicles, \$195 million must be spent each year. These foreign exchange expenditures greatly increase the local burden, and that burden has already become difficult to bear.

The significance of developing domestic production lies not merely in its being an effective means of easing the shortage of foreign exchange; it is also a long-range policy for promoting progress in Shanghai's industrial technology.

Color televisions, refrigerators, washing machines and automobiles are all new, technology- and capital-intensive industries with a broad range of cooperative and accessory activities with broad multiple interrelationships with all the sectors in the economy. For example, in the production of color televisions, the manufacture of multiple copper foil plate alone involves the chemical industry, light industry, and metallurgy. The finished-product and accessory plants for refrigerators span seven industrial sectors. Automobiles are a machine product with an even more pronounced aggregative character; their production involves steel, petroleum, rubber, paint, plastics, glass, and other industries. The specialized plants providing accessory parts for the Santana include more than 90 plants in the automobile sector and outside it, in the city and outside it. The development of such longtou [7893 7333] product is capable of spurring on all industry, science, and technology, and even the growth of the national economy. Production of accessory components involves a high level of technological requirements and difficulty. There currently exist great gaps both in technological levels and the organization of production, leaving them far from adequate to meet the needs of the main auto plant. Therefore technological transformation must be accelerated in order to overcome the contradiction between high technical requirements for end products and backward basic industry. To this end, the domestic production of parts must be spurred on, according to the policy of self-reliance and making foreign knowledge serve Chinese uses, by assimilating imports, uniting to attack key problems, testing and disseminating, manufacturing our own complete products, and bringing in complete technologies. By improving the quality of domestic production of principle parts we must promote the production of complete products, creating an industrial system with independent research and development that develops a new generation of products of international quality.

## II. Domestic Production of Parts at Present

Work toward the domestic production of longtou [7893 7333] products in this city has attracted the attention of the relevant sectors and industries; a good deal of work has been done, and a certain degree of success has been achieved, but this has been very uneven, and a good many problems remain.

Work towards the domestic production of color televisions began quite early, in 1980; the present degree of domestic production is currently limited to small runs of whole-set production (excluding the picture tube). Extrapolating from figure on foreign exchange spent to import component parts in 1985, the rate of domestic production is only 35 percent at present. Therefore, the component parts and materials making up color televisions should be further expanded quantitatively, further improved qualitatively, and further diversified in terms of variety. Vertical depth in particular must be developed and secondary and tertiary complementary work increased.

Work toward the domestic production of refrigerators has already met the plans and the key production points set for it. The city has now brought in four refrigerator assembly-production lines; however, the original industrial base for accessory and spare parts is weak, so that there is an ever-increasing shortage of parts.

At the end of 1985 the rate of domestic production of the Santana automobile had reached 23.4 percent, but the vertical rate of domestic manufacture was 20.7 percent, and the horizontal rate was only 2.7 percent. Clearly the horizontal rate of complementary production is exceedingly low.

There are many reasons for the slow progress in domestic production of these products' accessory parts; there are technical problems, problems in coordination, and systemic problems.

Problems persist in the ideas of what to import, including the emphasis placed on single units, production lines, light software (qing vanjian [6535 6516 0115] and soft technology. Some people believe that now that we have done just fine by importing production lines, we can take a breather. They do not realize that importing production lines is just the first step, and that the really arduous work lies ahead. In terms of the proportion of projects in other provinces and municipalities involving the importing of refrigerator accessories in the total amount of foreign exchange expended on refrigerators, the figures are 93 percent for Beijing, 89.5 percent for Tianjin, and only 27 percent for Shanghai. This shows that other areas are very enthusiastic about working on the domestic production of accessory parts. Shanghai has strong accessory production capacity relative to other provinces, however, the percentage of imported accessory parts projects is much lower than in other provinces and municipalities; thus the production of whole units and of accessories clearly cannot be coordinated.

In terms of technology, accessory parts have high requirements and involve a high degree of difficulty, with the process going from testing and development, to finalizing the design, to mass production. Tremendous effort must be expended. As accessory parts production is now in the testing and development stage, the prices of the accessory parts developed are far above those of imports. For example, color television semiconductor parts include 17 products, with a production cost of 40.92 yuan each, whereas the import price, converted at a ratio of 1 to 5, is only 15.50 yuan. The price of Dalian multiple copper foil plate is 28 yuan per kilogram, while the converted import price is 15 yuan. If enterprises consumed 1,000 tons per year, they would lose 13 million yuan. The high prices of domestically produced components means that factories producing complete units are unwilling to use them, and the factories producing components are unwilling to produce at a loss or at reduced profit.

In terms of coordinating the production of accessories, the production of these products is a systemic project requiring horizontal coordination among a great many enterprises, so that exclusive reliance on cronies or free association is difficult.

In terms of the enterprise's own funds, domestic production of accessory parts for these products requires major investments of manpower, materials and financial resources, and the enterprises are hard pressed to support this. Enterprises currently have a heavy tax burden and low profit-retention levels; they already feel their funds are short and are unwilling to discuss developing new products.

In terms of the investment system, the present system is unsuitable as well. The amount invested in the Santana production line, for example, is equivalent to the first-stage investment in a complete petroleum plant. Few specialized companies are in a position to make such a huge investment out of their own expenditures.

In terms of policy, no corresponding preferential policy has yet been set for Shanghai's automobile production, whereas a whole series of preferential policies have been set for Shenyang's No 2 Automobile Factory and other enterprises.

### III. The Way to Accelerate Domestic Production of Accessory Parts

How is the domestic production of accessory parts to be accelerated? I believe we should begin by focusing on policy and organization, working along both lines.

First, more emphasis should be placed ideologically on the importance of making technology Chinese, in order to strengthen the sense of urgency and responsibility, and a thorough conception of making technology Chinese should be instilled. Although the task of domestic production of accessory parts is an onerous one, it is one that can be properly done, considering Shanghai's technical capacity for coordinating accessory manufacture. The key lies in how to organize and support this in order to strengthen the vigor of enterprises for self-transformation and self-development. In addition, when transformation is inadequate for older enterprises, new industries must be developed.

Second, a policy breakthrough should be made in the areas of encouragement and support, with a number of special policies being implemented to create the necessary conditions for the enterprises. Preference should be given in such areas as taxes, credit, profit rates, pre-tax returns, foreign-exchange bonuses after "substituting [domestic] production for imports," staff and worker welfare, etc.

Third, organizational leadership should be improved in order to adapt it to the characteristic multifaceted nature of the production interrelationships. Making technology Chinese spans sectors, regions, and industries; the relevant departments must be organized so as to strengthen leadership over the work of making technology Chinese. The technology of products produced on imported production lines must be assimilated on a focused basis, item by item. Domestic production of accessories for key products must be systematically analyzed, with measures adopted according to the sequence of accessories. Departmental and industrial boundaries must be broken through; forces must be organized to coordinate the attack on key problems.

Transferring the potential of the advanced technologies and equipment of military and industrial departments over to civilian use merits serious consideration. In a time of peaceful construction, this approach can reduce the state's expenditures on the immense military production system and will facilitate improvements and development in the applications of science and technology. Shanghai has already gained some experience in this area, and that experience is worth disseminating.

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FOREIGN TRADE AND INVESTMENT

PLANS FOR SHENZHEN OVERSEAS CHINESE CITY OUTLINED

Beijing LIAOWANG OVERSEAS EDITION in Chinese No 33, 18 Aug 86 pp 14-17

[Interview with Liao Hui, director of the State Council's Overseas Chinese Affairs Office, and Liang Lingguang, Chairman of the Board of China Travel Service (Hong Kong), Ltd., conducted by Niu Zhengwu [3662 2973 2976] in Shenzhen; date not specified: "Building an Overseas Chinese City so as To Win the Hearts of People of Chinese Ancestry"]

[Text] Almost a year ago, on 25 August 1985, Ye Fei [5509 7378], vice chairman of the NPC Standing Committee and chairman of the NPC Overseas Chinese Committee announced an important piece of news--China is planning to build an overseas Chinese city. Now, nearly a year later, important questions still remain: Has the plan been put into effect? Have general plans been drawn up? How big will the city be? And what kind of investment policies will be provided?

Not long ago, Liao Hui [1675 2547], director of the State Council's Overseas Chinese Affairs Office, and Liang Lingguang [2733 7227 0342], chairman of the board of China Travel Service (Group) (Hong Kong), Ltd., met in Shahe, Shenzhen with Ma Zhimin [7456 1807 3046], director, and other responsible members of the Overseas Chinese City Construction Headquarters to review general plans for the city. This reporter put the above questions to these comrades during an interview.

Reporter: Why do you want to build this overseas Chinese city? What is the purpose of the project?

Liang Lingguang: The idea to build the city by no means originated last year. It was first proposed by Vice Chairman Liao Chengzhi in 1983, and we had planned to have the Overseas Chinese Affairs Office take direct charge of the development of the Shahe district of Shenzhen. The plan was delayed however, because conditions in various respects were insufficiently ripe. But in October of last year, the CPC Central Committee and the State Council formally approved the plan to build an overseas Chinese city in Shahe and to make this city a window and base with which to attract more overseas Chinese investment and in which to better implement the policy on overseas Chinese. I believe that the successful establishment of the city will play a big role in helping to unite overseas Chinese, in attracting imports of technology, funds and

skilled personnel and in accelerating the four modernizations. Deng Xiaoping has stated that special economic zones [SEZs] must serve as quadruple windows (for technology, management, knowledge and policy). And Premier Zhao Ziyang has stressed that opened regions and coastal cities must radiate outward and inward. Without a doubt, the overseas Chinese city must be established in accordance with the demands of the central leadership and function as a "quadruple window" and "double radiation." Even more must the city serve as a window and model for the implementation of the policies on overseas Chinese affairs, on foreign economic relations, on united-front affairs and on intellectuals.

Liao Hui: This project is by no means designed merely to develop this zone but has been conceived with the entire program of the four modernizations in mind, in the hope that this window and base will serve as a model for the creation of a new environment for people of Chinese ancestry residing both in China and abroad to invest in the economic development of their homeland. The CPC Central Committee, the State Council and the central leadership all have fully supported the project. General Secretary Hu Yaobang wrote an inscription dedicating the city on 25 October 1985 and thus expressed his enthusiastic support for this new undertaking. And Guangdong Province and Shenzhen City have also been fully supportive.

Reporter: Why was Shahe chosen as the site of the overseas Chinese city? What are the local conditions like? How big will the city be?

Liao Hui: The choice of Shahe was based first of all on the fact that the district has a good location and suitable environment. The site is located between the Shenzhen SEZ's Luohu District and Shekou Industrial Zone, with Luohu lying 13 km to the east and Shekou 13 km to the west; has hills at its rear and faces the sea; looks across Shenzhen Wan to the New Territories of Hong Kong; is connected to Kowloon by an overland route of only 50 km; has a total area of 5 sq km and much developable flat land; and has beautiful surroundings and a pleasant climate. The district has convenient transportation and is traversed from east to west by Shenzhen-Nantou Highway in the south and Northern Loop Highway in the north, which routes connect the district with Hong Kong and Guangzhou. The planned Guangzhou-Shenzhen Expressway will skirt the northern edge of the site. And nearby Shekou and Chiwan harbors provide sea transport services.

Second, Shahe was selected because it already possesses an excellent foundation. Some existing enterprises in the zone are run by overseas Chinese. The Guangdong Shahe Overseas Chinese Enterprises Co has successfully engaged in construction work here for many years and has more recently signed nearly 30 agreements with Hong Kong compatriots and people of Chinese ancestry from Southeast Asia, Europe and the Americas and imported more than 300 pieces of advanced equipment. Joint-equity and cooperative-venture enterprises include the Guangming Overseas Chinese Electronics Plant, the Shahe Overseas Chinese Electronics Plant, the Shenzhen Overseas Chinese Furniture Factory, the Overseas Chinese Blueprint Paper Plant, the Huali Cardboard Box Factory, the Xinghua Zipper Plant and the like. These enterprises, most of whose output is sold abroad, have increased from none to many, grown from small to large and accumulated experience and trained new ranks of personnel as they developed.

The district also possesses electrical substations, water pumping plants, commercial outlets, schools, hospitals, hotels, large amusement parks and other facilities. So this area naturally is a very good site in which to build the overseas Chinese city.

Reporter: Has the general plan for the project been completed? And what are the project's guiding principles going to be?

Liang Lingguang: The general plan has already been drawn up, as have detailed plans for the first stage of construction. All of the plans have harmonized the natural and man-made environments, both protecting existing hills, lakes, forests and streams and providing for buildings, roads, tourist facilities and other modern architectural forms. The project will be carried out in three stages. During the first stage, we plan to develop 2 sq km, establish industries that are "precision, small, skilled and novel"; to build a cultural-tourist center called "Beautiful China" that will be a "pocket-sized" menagerie of the famous sites and ancient relics of China; and to construct housing units for overseas Chinese who come to the area to work for short periods of time, to vacation or to reside for long periods of time, as well as schools, hospitals, commercial service establishments and the like. The guiding principles of the project may be summarized in a few phrases: "Industry will be primary, cordiality will be fully extended, the surroundings will be beautiful and the city will be distinctive." In accordance with these principles, the project will create a beautiful satellite city that is rooted mainly in export-oriented industry; that is equipped with commercial outlets, tourist establishments, apartment housing and cultural and educational facilities; and that retains the atmosphere of the hometowns of emigrant Chinese.

Reporter: What kind of administrative form will this project take? What will the leadership structure be like?

Liao Hui: In general, the project will adopt the approach employed in Shekou, which was developed by the China Merchants' Steam Navigation Co, and will place the China Travel Service (Group) (Hong Kong), Ltd., in charge of the entire operation. This company has more than 60 years of experience as a Chinese investment group in Hong Kong, a good reputation, wide contacts among overseas Chinese and considerable economic strength and is diligent, energetic and enterprising. Thus the selection of this company is very appropriate. Of course, the company, though very experienced in the travel and shipping businesses, lacks similar experience in construction. So the company needs reinforcements and must experiment boldly and advance by pioneering new trails. As for the leadership structure, the overseas Chinese city must follow the guidance of Shenzhen City and the general plans of the SEZ but also enjoys considerable autonomy.

Reporter: What are the policies on investment in the overseas Chinese city going to be? What kind of preferential treatment will be accorded overseas Chinese investors?

Ma Zhimin: The city's policies will be very advantageous to investors. Overseas Chinese who invest in the city will enjoy the preferential treatment



accorded by the SEZ as well as that extended to overseas Chinese nationally. That is, investors will enjoy double preferential treatment. Specifically, this treatment will include the following elements.

1. Preferential treatment in terms of import and export duties. Mechanical equipment, parts, raw materials, conveyances and other means of production needed by enterprises in the city may be imported free of duty and are also exempted from the industrial and commercial consolidated tax. Finished and semi-finished goods produced for foreign markets by city enterprises will also be exempted from export duties and the industrial and commercial consolidated tax. Import duties and consolidated tax on office supplies and daily necessities used by foreign businessmen and foreign and Hong Kong-Macao employees will be reduced or waived. And housing purchased by these people in the city will also be exempt from taxation.

2. Preferential treatment in terms of income tax. The income tax rate in the city will be 15 percent, but no local income tax will be assessed. Income tax assessments on enterprises in which overseas Chinese invest will be waived for the first 3 years of profitability and reduced by one-half for the next 4 years. Taxes on profits that enterprises reinvest in the city may be reduced by 50 percent for 5 years or more. And the after-tax shares of profits distributed by enterprises may be repatriated income-tax free.

3. Preferential treatment in terms of land-use fees. In accordance with relevant criteria established by Shenzhen, fees for land used by overseas Chinese enterprises may be reduced or waived as appropriate under specific conditions. Land-use fees for enterprises employing advanced technology will be waived for 5 years and reduced by one-half for the next 5 years. Projects employing especially advanced technology will be completely exempt from paying land-use fees.

4. Preferential treatment in terms of management. Overseas Chinese participating in joint-equity ventures or running wholly owned enterprises in the city may appoint relatives or friends in China to serve as representatives or agents. Overseas Chinese enterprises in the city may determine, in accordance with relevant conditions, their own forms of wages and systems of incentives and subsidies and fire employees violating contract terms. Enterprises terminating operations in the city may transfer their capital or reinvest or repatriate their funds after completing business-termination formalities, settling debts and paying off creditors.

5. Preferential treatment in terms of marketing. Enterprises in the city must market most of their output abroad but, upon approval from relevant departments, may sell a certain proportion of their goods on China's domestic market. However, the majority of the output produced by enterprises employing advanced technology or that can be substituted for other imports may be marketed domestically.

6. Preferential treatment in terms of immigrations. Overseas Chinese who invest in the city may apply for multientry-exit visas or permanent residence.

Investors may employ an appropriate number of their family members in their enterprises, and an appropriate number of relatives may be permitted to take up residence in the homes purchased by overseas Chinese.

Liao Hui: I advocate giving investors more preferential treatment, adopting enlightened policies and reducing the burdens on and increasing the earnings of investors. Only in this way can we attract investors.

12431

CSO: 4006/63

FOREIGN TRADE AND INVESTMENT

ZHENG TUOBIN DISCUSSES RECENT DEVELOPMENTS IN FOREIGN TRADE

Hong Kong CHING-CHI TAO-PAO [ECONOMIC REPORTER] in Chinese No 41, 13 Oct 86 pp 24-25

[Interview: "On the Eve of the 60th Guangzhou Trade Fair, Minister of Foreign Economic Relations and Trade Zheng Tuobin Discusses New Conditions and New Changes in China's Foreign Trade"; date, place and interviewer not specified]

[Text] Prior to the opening of the 60th Chinese Export Commodity Fair, reporters from this journal interviewed Chinese Minister of Foreign Economic Relations and Trade [MOFERT] Zheng Tuobin [6774 4801 1755]. The following is an edited version of Minister Zheng's discussion of the current state of China's foreign trade and other issues.

Question: Minister Zheng, please briefly describe the developments in China's foreign trade since the beginning of this year.

Answer: This year, the first in China's Seventh 5-Year Plan, has witnessed steady growth in foreign trade, continuing the pattern of more rapid development established during the Sixth 5-Year Plan. Since the beginning of the year, exports continued to grow steadily but at rates that are unusually high in comparison to recent years. According to MOFERT's operations statistics for the period between January and August, imports and exports totalled \$36.55 billion, an increase of 3.7 percent over the same period last year; exports totalled \$17.36 billion, a rise of 12.3 percent; and imports were \$19.19 billion, a decline of 3 percent.

Several New Developments

In terms of import and export performance over the last half year, the development of China's foreign trade can be roughly summarized as follows.

First, the trade deficit was greatly reduced. Between January and August the deficit was \$1.83 billion, down \$2.5 billion from the \$4.33 billion registered during the same period last year.

Second, a distinct change occurred in China's export mix. Foreign-exchange revenues from petroleum declined considerably from the same period last year due to the slump in international oil prices and the fall in the volume of

petroleum China exported. Nevertheless, other exports increased rapidly, not only recouping the loss in oil revenues but also increasing total export value. The largest increases were registered by light industrial goods, textiles, grain, oil, foodstuffs, native products, animal byproducts, arts and crafts, metals, minerals, machinery, equipment and the like. Clearly, exports of manufactured goods increased rapidly, and light industrial goods, textiles, agricultural produce, sideline goods and native products played a prominent role as the main pillar of China's export trade.

Third, there was considerable change in China's import mix. Compared to the same period last year, imports of new technology, complete sets of equipment, machinery, instruments, copper materials and the like rose rapidly, whereas those of copper, aluminum, chemical fertilizer, pesticides, granulated sugar and electrical appliances markedly declined.

Fourth, there were new changes in the direction of China's foreign trade. Exports to Japan declined due to the petroleum market problem, but those to Macao, the United States, Canada, the EEC, the Soviet Union, Eastern Europe and especially Hong Kong rose. Imports to Japan, Macao and other countries and regions declined, but those to other major countries and regions rose in varying degrees.

In short, conditions so far this year indicate that China's foreign trade continues to develop in a healthy fashion in accordance with the targets set forth in the Seventh 5-Year Plan.

#### The Effects of the Fall in Oil Prices

Question: What kind of impact has the fall in petroleum prices actually had on the growth of China's foreign trade?

Answer: Petroleum is one China's leading exports, and the fall in prices and export volume since the beginning of the year definitely has greatly reduced foreign-exchange revenues from that source. Nevertheless, the trend toward increasing activity on world markets has provided us an opportunity to increase non-petroleum exports. Except for petroleum, all our other exports increased between January and August, and this kept our total export value from falling, which it might have done due to the decline in oil revenues, and allowed our exports to continue their steady growth. In addition, the decline in oil prices will reduce manufacturing costs in Western nations, which will make it possible for us to obtain foreign technology and equipment at lower prices and reduce our expenditure of foreign exchange. In short, the decline in petroleum prices has had favorable as well as unfavorable effects on China's foreign trade. We must fully exploit favorable conditions and reduce the effect of unfavorable ones so as to develop China's foreign trade.

#### Favorable Factors

Question: On the basis of performance during the first eight months of this year, what do you think the prospects are for the growth of China's foreign trade for the entire year? Do you think the foreign trade deficit will be reduced for the year?

Answer: Though petroleum prices have recovered somewhat, they are still quite low, and this will affect China's revenues from petroleum exports, which is disadvantageous for the growth of her foreign trade. Nevertheless, there are many favorable factors, as well, and the most important of these are as follows. (1) Because all quarters are placing heavy emphasis on earning foreign exchange through export this year, export work has been handled attentively and quickly, and the state's policies to encourage exports have been implemented promptly and are already beginning to take effect. Thus export trade has been good so far this year, growing faster than in previous years. (2) Since the beginning of the year, industrial and agricultural production has continued to grow in a stable and coordinated fashion, and industry and agriculture have stressed product quality, especially export quality. Both of these developments have served to provide a good material basis for ensuring greater supply of marketable goods for export. (3) In early July, the state devalued the renminbi in accordance with changes in domestic and international prices, and this move will help promote growth in exports and balance in foreign exchange. (4) While invigorating the foundation of foreign trade, we have also strengthened management thereof. Early this year we initiated a system of quota licensing for 235 commodities exported to Hong Kong and Macao and have obtained outstanding results with this system. For some large-volume exports, we have already stanchied the torrent of parallel goods and have begun to eliminate competitive price slashing. Thus market conditions for these goods are better, supply is stabilizing and sales, prices and foreign-exchange earnings are increasing. (5) Except for petroleum, international demand is rising for other commodities, the Japanese yen has been greatly revalued and these developments will help increase China's exports of manufactured goods. All of these factors have created excellent conditions for the continued development of China's export trade. We expect that exports will continue to grow in the second half of this year, that foreign trade will show further growth for the entire year and that the foreign-trade deficit will decline greatly from last year's level.

Wishing the 60th Trade Fair a Complete Success

Question: This fall's trade fair is the 60th. What role has the fair played in the development of China's foreign trade?

Answer: The Chinese Export Commodities Fair was established in 1957 and over the last 30 years has been run increasingly better and has greatly expanded following the steady growth in China's industrial and agricultural output and especially after China implemented the policy of opening up to the outside world and after she expanded her international, economic and trade relations and reformed her foreign-trade administration. If we compare last spring's trade fair, the 59th, with the 1st, the number of foreign business participants rose from 1,200-some people to more than 26,000; the number of trade delegations increased from 8 to 15; the number of Chinese administrative systems involved in foreign-trade talks rose from 8 to more than 60; floor space in the exhibition halls and negotiation rooms increased from 12,000-some square meters to 110,000; the number of commodities exhibited rose from 12,000-some to about 50,000; and sales volume increased from \$87 million to \$3.2 billion. In each recent year, the spring and fall trade fairs have

accounted for more than 20 percent of China's total export volume. In addition, each fair also handles much import trade. Thus the Canton Trade Fair has become an important arena in China's foreign trade, a major window in China's policy of opening up to the outside world and a grand international trade event that is famous throughout the world, and has played an important role in the continuous development of China's foreign trade, especially her export trade. In the future, we must continue to do a good job in running the trade fair. I believe that, through the joint efforts of all quarters, this fall's fair will be another successful and magnificent event. I wish the fair complete success and hope it will make even greater contributions to the advancement of China's foreign trade work.

Finally, on behalf of MOFERT, I would like to take this opportunity to extend a cordial welcome to industrialists and businessmen of every country and region throughout the world to come to the fair to visit, talk business and build friendship.

12431

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FOREIGN TRADE AND INVESTMENT

ABOLITION OF FOREIGN EXCHANGE CERTIFICATES EXAMINED

Hong Kong CHING-CHI YU FA-LU [ECONOMY AND LAW] in Chinese No 9, 1986 p 33

[Article by Feng Muqing [7458 2606 3237]: "Various Sides to the Abolition of Foreign Exchange Certificates"]

[Text] Ever since foreign-exchange certificates [FECs] were first issued 1 April 1980, they have served to a certain extent to protect the interests of enterprises in which foreigners have invested and to prevent leakage of foreign exchange [FE]. Yet they have also produced a number of harmful effects and thus have been the subject of considerable criticism. One of the critics is Qian Jiaju [0578 1367 7467], a nationally famous economist who has been a strong advocate of abolishing the FECs. In the second half of this year, central authorities finally decided to stop issuing the certificates 1 October of this year and to ban circulation shortly thereafter. As of mid September, however, the State Council had failed formally to announce this decision, yet many responsible authorities dealing with the issue had already revealed the gist of the decision. Qian Jiaju, who arrived on a visit to Hong Kong at the end of August confirmed the news to local media, disclosing that central authorities had already drawn up a number of related measures and stating that he personally thought these measures would prevent the reform from having a major untoward impact on China's FE reserves and on foreign enterprises.

Factors favoring abolition. It seems inevitable that the step will be taken to abolish FECs. Indeed, central authorities had desired to do so as early as 1983 but did not act due to strong opposition from Guangdong. During the early part of this year, however, the call for abolition began to spread again, and Yao Yilin [1201 0181 2651], vice premier of the State Council, expressed his view on the matter, stating that FECs must be abolished but adding that a considerable amount of time would be required to prepare for the move. This view was shared by banking circles, which thought that several years might be necessary. Nevertheless, a great breakthrough on the matter occurred during the second half of this year, when relevant authorities disclosed that FECs would be abolished this October, a great advance in schedule over the original notion that the reform could not be implemented for several years. Roughly speaking, there are only two factors favoring abolition by the end of this year. The first is that domestic circulation of high-grade commodities, especially in Guangdong, has already greatly increased, and there is ample supply of many goods that can be purchased without FECs. In addition, since

taxis and some hotels have begun accepting renminbi [RMB], FECs have already lost part of their function in the marketplace. Second, the RMB has already undergone a major devaluation, and efforts are being made to bring official exchange rates into line with those on the black market. Thus current RMB rates may become a factor stanching large FE flows into the black market once FECs are abolished. Most outside observers believe that the RMB was devaluated as a preparatory step for FEC abolition, but Qian Jiaju has indicated that this is not really the case. He says that the RMB was devalued primarily to stimulate exports and reduce imports.

Arguments for abolition. The move to abolish FECs is primarily due to political and financial reasons. Politically, FECs undermine national standards and reduce the RMB to a second- or third-class currency, which tendencies are harmful to China's image and will make the masses dissatisfied with the government and cause people to lose confidence in the national currency. Although black market trading will persist after FECs are abolished, hidden activity seems, after all, less unacceptable than open operations. Financially, FECs are disruptive to the national banking system because they have evolved into a foreign currency that is more highly valued than the RMB, so there is serious hoarding and trading among private individuals and units, all of which tendencies are not what was intended when FECs were first issued.

Abuses that will arise from abolition. Abolition of the FECs will be beneficial both politically and to the nation's financial system. Yet because the nation's FE reserves are limited and because the official exchange rate still does not reflect the true value of the RMB, abolition of FECs, which serve as FE claims dominated in RMB, will create a number of intractable problems. For example, abolition may greatly dampen enthusiasm among foreign businessmen for investment in China or lead to FE leakage due to hoarding. Qian Jiaju has disclosed that central authorities will assign FE approval to the provincial level once FECs are abolished. Yet proper standards for FE approval are hard to determine. If they are made too strict, they will stifle foreign enterprises, if too lenient, they will lead to hoarding and profiteering among foreign enterprises and to a steady fall in the nation's already diminished FE reserves. Technical problems will be especially large in Guangdong, because joint-equity and foreign wholly owned enterprises abound in that province, so standards that are just a little too strict or a little too lax might have a tremendous impact. A second possible development is that demand for imports may swell as a result of abolition. In recent years some Chinese have enjoyed tremendous increases in income and thus now have the financial resources to purchase high-grade imported goods. But when markets for these goods, which currently require FE to buy, are transformed into RMB markets, the amount of FE the nation expends on imports is bound to rise greatly, and sellers will receive only domestically used RMB. According to Qian Jiaju, the state, to counter these problems, may try to control import volume or increase the price of imports by devaluing the RMB. Yet these measures ultimately will cause existing FE markets to dry up and lead to illegal high-priced trafficking of imports. A third problem is that abolition might create a rampant black market for Hong Kong dollars, for black market trading will mushroom if official RMB exchange rates are not reduced and brought into line with black market levels so as to engender a great increase in the amount of FE that is exchanged for RMB at the official rate. This trend



will ultimately cause illegal substitution of the Hong Kong dollar for FECs in Guangdong. (Legal circulation of the Hong Kong dollar in Shenzhen and Zhuhai will stimulate illegal flows of that currency in Guangdong.)

Policy responses to abolition. Will the abolition of FECs restore the situation that existed prior to 1980? Or will abolition merely create another substitute currency? At present, there are advocates of both approaches in China. The former is neat and efficient and appears to be what the leadership originally intended, but this approach will never resolve any of the problems that might crop up. Supporters of the latter approach advocate creation of such substitutes as travelers' checks or purchase coupons. Yet no matter what kind of substitute is employed, that currency will share a number of similarities with FECs. For example, purchase coupons, like FECs, will acquire value and will be very inconvenient for tourists. But all of this is speculative, because the state has yet to announce its program. We must wait until this program is really unveiled or is tried for a while before we can determine whether or not it can truly resolve some of these problems.

12431

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FOREIGN TRADE AND INVESTMENT

CHINA DEVELOPS COUNTERTRADE

Beijing GUOJI SHANGBAO in Chinese 23 Jun 86 p 1

[By own correspondent, signed Li [0500]: "China Vigorously Develops Countertrade"]

[Text] China is presently in the process of vigorously developing countertrade step by step to exchange commodities of which abundant supplies are available for raw materials for domestic production or for goods that are needed in the domestic market. According to initial statistics, the total amount of countertrade last year reached \$700 to \$800 million.

China employs mainly three types of countertrade: First, barter trade, when two parties exchange commodities of equal or almost equal value. Second, reciprocal purchases, when according to agreement the seller, after having sold his commodities, is obliged to buy from the buyer a certain amount of commodities; however, purchase and sale need not be of equivalent value. Third, compensation trade, when the exporting country, after selling its equipment, agrees that the purchase price will later be paid back, i.e., "compensated," by products manufactured by the said equipment. The above-mentioned statistics do not include the compensation trade category. Main items of China's barter trade are rice, cotton, tea, jute, grey cloth, cotton print, bicycles, and machinery and electrical articles. The proportion of primary products is comparatively large. Obtained by imports through barter are such industrial raw materials and market commodities, urgently needed in China, as timber, steel materials, cement, pig iron, motor vehicles, and sugar.

Representatives of the Ministry of Foreign Economic Relations and Trade have indicated that countertrade will not only expand the export of Chinese products, but will also help improve the trade balances with certain countries. This year, China is, furthermore, trying out barter trade by having import items stimulate the export of commodities by barter.

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CSO: 4006/1200

FOREIGN TRADE AND INVESTMENT

GOOD POTENTIAL FOR ZHEJIANG'S EXPORT LABOR

Hangzhou ZHEJIANG RIBAO in Chinese 24 Jun 86 p 2

[Article by Si Zhangfa [2448 2874 3127]: "Ample Scope for Zhejiang's Labor Export"]

[Text] Labor export is an economic field that has only recently been opened up by China; it is an effective pattern of active participation under current conditions in the international division of labor. Since it yields comparatively high overall economic benefits, it is generally valued very highly. Zhejiang Province has abundant resources of labor, its talents are of a comparatively high standing, it is in leadership position in the technology of certain trades, shows many favorable conditions for the development of export labor, and is therefore determined to work hard to become successful in labor export.

During the Sixth 5-Year Plan, Zhejiang Province achieved only 1 percent of the national volume of labor export business as well as of numbers of persons dispatched for work abroad, thus lagging far behind all the other fraternal provinces around us, completely out of proportion to the level of economic development and economic potential of the province. One of the reasons for this state of affairs is that mentality and knowledge lags behind developments. The traditional habit of closing the door to the outside world prevails. The idea is held that as long as it is possible to earn a living at home, why venture thousands of miles far away; there is also the fear that with the lack of experiences in these matters, one might easily commit serious mistakes, so that starting economic ventures abroad are regarded as perilous undertakings, and labor export is being talked about as if it were the same as the old Chinese coolie trade, raising doubts whether labor exports are not in conflict with the principle of upholding socialism. The second reason is that ineffectual measures had been applied. There was a lack of unified organization and command. Reliance was basically placed on having each unit make its own arrangements in piecemeal actions, each for himself, proceeding in a dispersed manner, without plan or consideration of demand. The administrative departments in charge did not fully exercise their administrative functions, and the quality of the enterprises did not prove up to the task. The third reason is a neglect in opening up new markets, a lack of reliable customers, vagueness about the crucial points, and again the employment of ineffectual measures. As a consequence, a high price was paid,

and little was achieved. The fourth reason is that the basic enterprises derived little benefit, a fact which dampened enthusiasm for the dispatch of personnel.

Experts project that the present international labor market still has a huge potential, that the world labor market will stay for a considerable time at the level of a demand for around 20 million people, and that Zhejiang Province will be able to make a large contribution. Zhejiang Province is determined to make it a key task during the Seventh 5-Year Plan, to open up the international market in a planned way and step by step, to establish and perfect a multilevel export system, expand the scope of exports, raise economic benefits, and turn labor exports into one of the major pillars of provincial exports and sources of foreign exchange. In concrete terms, we may proceed at four separate levels: First, the work force carrying out basic constructions in the building, water conservancy, hydroelectric, and communications trades are to be the core contingent. The key area in which they should establish themselves should be the Middle East, and they should actively create conditions to enable a branching out in two directions, namely toward North Africa and Southeast Asia. Second, the agricultural cultivation and breeding enterprises, fishery and industrial processing trades should seek expansion into the developing countries of Asia, Africa, Latin America, and Oceania. These areas are not yet developed, and the level of China's industrial and agricultural skills are well suited to these areas, which on their part are also willing to cooperate with us. Third, the catering services, medical and health services, service to seamen, expositions and performances, all parts of the tertiary industries, shall primarily expand into the developed countries of Europe, America, and Japan, and to the oil countries of the Middle East. Fourth, scientific and technological services, i.e., intellectual labor. That is the direction in which international labor trade will develop, and where Zhejiang Province could offer services, starting out with the design and consultations for greening by planting gardens and parks, constructions for civilian uses, for water conservancy and hydroelectric projects, and an introduction to the technique of silk manufacture and silk worm raising, and at the same time develop our software industry, contracting for software exports. The above four levels make up the overall situation of export labor from Zhejiang Province. Setting up these four levels by the year 1990 could result in almost as much, or even more, foreign exchange than earned in the tourist industry. By that time, a new branch of the economy will have emerged, with a full range of trades, with a wide range of activities, and of a considerable scope and strength in its capacity to earn foreign exchange.

Whether the above-described objectives can be achieved will critically depend not only on international political and economic factors, but on what measures will be taken to achieve that goal. According to the distinctive characteristics of export labor itself, and according to the actual conditions prevailing in Zhejiang Province, it is suggested to take the following ten measures: First, to effect a switch in the direction of foreign economic work, i.e., to change from the past unitary emphasis on commodity exports to an equal emphasis on both, tangible and intangible exports, and to implement this shift in the areas of ideology, organization, system, and work, so that labor exports and commodity exports will both together become the two wings

for the upswing in Zhejiang's foreign trade. Second, to effect a full ideological mobilization, use all effective forms and means to propagate the relevant general and specific policies of the central authorities, commend progress, overcome pessimism and outmoded concepts, and create a glorious socialist environment with enthusiastic labor exports that will contribute foreign exchange toward the four modernizations. Third, to include in overall planning the channels of the unified national economic plan of Zhejiang Province and carry out an effective plan management. The labor export plan of the entire province shall be unifiedly organized and drawn up by the planning departments, to become an organic component of the national economic plan for the entire province, to be uniformly transmitted for execution to the lower echelon, and should uniformly be shown participating in evaluations and statistics. Fourth, to exert efforts toward opening up international markets. Business should be solicited on many levels and through many channels by adopting an integration of a specialized with a nonspecialized labor force, integration of government with civilian forces, and the integration of units with individuals. Gradually, footholds and "windows" should be established abroad, gaining a set of relatively stable customers. Fifth, to change key points in the work and work methods of the international corporations of the province, fully asserting their function as "windows to the outside world." Sixth, to establish and train in a planned manner a reserve work force, integrating staff and worker education, with the study of foreign languages and enhancement of professional skills. Seventh, to adopt in the economic field policies and measures that are apt to arouse enthusiasm in all quarters. Eighth, to establish close coordination among all relevant departments in the province, have them cooperate with joint strength, and in the management institute a set of special methods and flexible measures, reduce links in the administrative chain, simplify procedures, and give the green light to labor exports. Ninth, to strengthen responsible management, and achieve unity in dealing with the outside world. Tenth, to bring up to necessary strength and improve the teams working in the international corporations, and establish boards of directors that are consistent with the tasks they have to perform.

9808

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FOREIGN TRADE AND INVESTMENT

BRIEFS

**ANHUI METALS EARN FOREIGN EXCHANGE--**At the Chinese Exports Exhibition which was recently held in Tokyo, the Anhui Nonferrous Metals Import-Export Co conducted trade talks with 184 costumers and concluded deals worth as much as \$1.42 million, exceeding sales targets by 182 percent and ranking at the top of the entire industry in terms of sales volume. Anhui displayed more than 30 nonferrous-metal products at this exhibition, and of the 11 products sold to foreign customers--metallic silicon, moissante, sponge palladium, ferro-molybdenum, molybdenum trioxide, ammonium molybdate, ferrosilicon, aluminum ingots and the like--80 percent had never been sold on the Japanese market before. These exports have changed Anhui's export mix and demonstrated the potential and prospects for her nonferrous-metal exports. The successful entry of Anhui's nonferrous metals into the Japanese market has aroused great interest within Japan's metallurgy industry. Representatives from this industry snapped up catalogs and indicated they hoped to establish and expand trade ties with the province. [Text] [Hefei ANHUI RIBAO in Chinese 19 Sep 86 p 1] 12431

CSO: 4006/72

## SPECIAL ECONOMIC ZONES

### SHENZHEN BANK FIRST IN NATION FOR RMB DEPOSITS

Beijing GONGREN RIBAO in Chinese 20 Jun 86 p 1

[Article by correspondent Sun Shengzhu [1327 0524 2691] and reporters Zhou Ruifu [0719 3843 1381] and Liao Shoulun [1675 1108 0243]: "Up Against Powerful Forces, But Strengthening Own Competitiveness By Excellence of Service, the Shenzhen Branch of the Bank of China Leapt to First Place in the Country's Total Intake of RMB Deposits"]

[Text] The Shenzhen branch of the Bank of China started out with an emphasis on excellence of service as an expression of civilized teller window service to raise service quality and work efficiency, thereby gaining an excellent reputation among its Chinese and foreign customers. Last year, this bank leapt to first place in the country's intake of RMB deposits, and last year ranked among the best in net profit earnings of the Bank of China's network in Guangdong. Since the start of this year, the various lines of business at the said bank have still been on the increase, and recently, the summary review of the Chinese Banking Trade Union expanded their experiences.

In the last few years, there has been fierce competition between the 28 foreign banks and the branches of the several other domestic banks. Particularly 24 foreign banks with abundant capital, favorable interest rates, flexible service, and advanced equipment maintained a powerful offensive. Facing this situation, the mentioned branch bank called all employees together for a discussion of the question how to improve service attitudes and raise service quality. Opinion was unanimous among all employees that the quality of service and the amounts of deposits taken in have a direct bearing on the construction of the Shenzhen special economic zone and on the support of the four modernizations. They raised the slogan: gain a high reputation by giving excellent service and attract customers as a means to expand the financial resources of the four modernizations. At the 6 sub-branches, 14 local offices, and 18 business offices of the entire branch, emphasizing civilized service at teller windows was made the starting point in venturing into competition. They improved service installations at the branches, sub-branches, and offices, increased seating facilities and desks, and put up potted landscapes and flowers to provide the customers with a comfortable environment to conduct their business. To increase efficiency, they successively added various calculators, computers and a "computer networking" service between some branches and sub-branches so that customers can

withdraw what they need at any time and at any sub-branch throughout the city. To expand the scope of services, they successively inaugurated discounting of promissory notes, guaranteeing delivery of goods under letters of credit, checking and approving letters of credit and amounts involved, etc. They also instituted, depending on local conditions, international leasing operations, travel information, and translation services, established the business of "safe deposit boxes," and together with the Takushoku Bank of Japan, pioneered a "Shenzhen Industrial Development Credit Fund," and with the use of their computers issued salaries and wages on behalf of the municipal government and several other units.

To improve service quality, business personnel tackled the problem of being unfamiliar with the currency of certain countries, unfamiliar with the nonsimplified Chinese characters, and ignorant of foreign languages, by eagerly joining training classes on such special business topics as accounting, depositing and remitting, accounts settlements, credits, etc., training while working full time in their jobs. Some young members of the business staff even delayed their weddings for this reason and gave up rest on holidays and rest days. Through 1 year's hard work, the quality of work at the various offices and substations markedly improved. They became capable not only of servicing Chinese and foreign customers with high efficiency, but also displayed a high sense of responsibility for their customers and transacted many important and complicated business operations. In July last year, the Dongfang Trading Co. of Shenzhen ordered 250,000 dozens of fiber-tip pens. After establishing a letter of credit through the Shenzhen branch of the Bank of China, delivery was made but found to be nothing but waste paper. The bank saw six discrepancies on the documents and refused payment, and actively helped the customer to recover his HK\$1,090,000.

By raising their service attitude to high moral standards and to the height of the spiritual style of socialist employees, they recognized that each worker must be "thinking what the customer thinks and feeling the urgency of the customer," give customers every facility and make this the uppermost article of faith. The entire branch bank held service quality and service attitude competitions. On one occasion, two employees specially made the trip from Yunnan to Shenzhen to attend to an urgent business matter. As soon as their train arrived, they went straight to the Bank of China, but it was past office hours. The staff of the deposit and remittance department first invited the two employees for supper, then brought them to the leading cadre of the department concerned, and had them finally satisfactorily settle all their business affairs, which made the two employees deeply grateful; they expressed their gratitude repeatedly.

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## SPECIAL ECONOMIC ZONES

### SHENZHEN'S EXPORT-ORIENTED ECONOMY

Guangzhou NANFANG JINGJI [SOUTH CHINA'S ECONOMY] in Chinese No 6, Dec 85 pp 20-26

[Article by Li Kehua [2621 0344 5478]: "Some Problems in the Transformation of Shenzhen's Economy to an Outward-Oriented Economy"]

[Text] Building up the Shenzhen special economic zone [SEZ] into a comprehensive export-oriented special zone is the firm policy of the Central Committee, as it is also the expectation of all the people. What has Shenzhen accomplished during the 6 years of its experiment as an SEZ? What are presently the salient features of its economic development? What special features are required in an export-oriented economy? In what direction must special efforts be exerted to transform the economy of the Shenzhen SEZ into an export-oriented economy? All these questions are urgently awaiting study and solutions. This writer has drawn up some ideas in a discussion of these questions for a joint exploration together with all interested parties.

#### I. The Present Fundamental Characteristics of the Shenzhen SEZ's Economic Development

Six years have passed since the central authorities, in July 1979, approved opening up Shenzhen as an SEZ. Thanks to a series of wise policy decisions of the Central Committee, and also due to the untiring efforts of those engaged in the construction of the SEZ, Shenzhen has been developed during this space of time from a little frontier town into a modern medium-sized city of considerable initial dimensions. The following is a broad outline of the special characteristics of the Shenzhen SEZ's economic development:

First, the infrastructure has been initially completed to a considerable extent, to provide favorable investment conditions for foreign investors. In the last few years, the Shenzhen SEZ has taken a lesson from the experiences made throughout the world in the establishment of special economic zones and has vigorously pushed the completion of its own infrastructure. The "seven components of the infrastructure and leveling of the ground" have been completed over an area of more than 400 sq km in the Luohu, Shangbu and Shekou districts. A total of RMB 4.6 billion yuan has been invested up to the first half of 1985, and work has been completed over an area of more than 7.3 million sq m. Within the zone, 11 roads of a total length of over 100 km have

been newly built or widened, the reconstruction of the Luohu railway station has been accelerated, and the double-tracking and electrification of the Guangzhou-Shenzhen line completed. The passenger wharf at Shekou, the berths at Chiwan as well as the heliport at Nantou have been opened to traffic. A network of domestic and overseas communication lines has initially taken shape. A 14,000-channel program-controlled telephone exchange has been imported, with the cooperation of foreign firms, making it possible to dial Hong Kong directly and providing service for domestic and overseas long-distance calls, initially modernizing communication methods. Several facilities for the supply of electric power have been newly built. Construction work on the Shajiao power plant and the Dayawan nuclear power plant is being vigorously pushed, to accelerate the improvement in the power supply system for the SEZ. Over 2,000 multi-storied buildings of various types have been built, of which 97 are highrise buildings of 18 or more stories, completed or in the process of being built. Five new industrial districts have been set up, and somewhat over 380 new factories have been built. Furthermore, many new houses for employees, houses for rent or sale, high-class restaurants, guest houses and markets, equipped with all modern conveniences, have been constructed. More than 10 recreation centers with all modern facilities have been set up at scenic spots. An 84-km long administrative line delineating the SEZ from the outside area--a patrol highway with 6 border check points--has been built, etc. All this indicates that the infrastructure of the SEZ has reached a certain dimension and that favorable conditions have been created for visiting foreign businessmen coming to invest in Shenzhen.

Second, economic laws and regulations, as well as the organization for their implementation, have been perfected, basically ensuring that all operations of the SEZ will be carried on according to law. During the past 6 years, the Shenzhen SEZ, with the assistance of relevant departments, has at different times drafted more than 20 special laws, of which 12 have been approved, promulgated and put into effect. Some of the special laws and regulations that are in force are: on land administration and on the registration of enterprises as well as their enforcement regulations, on the entry and exit of personnel, on worker wages, on commodity and real estate administration, on economic contracts with foreign parties, on the importation of technologies, on the control of foreign banks, on the preferential reduction or exemption from industrial and commercial tax and land rental fees. The SEZ has, furthermore, set up a law court for economic cases, a legal counseling office and an office for economic arbitration. The SHEKOU NEWS, issue No 9, reported the case of a foreign enterprise having delayed for over 1 month to report statistical data in disregard of the law, and that the case had been satisfactorily resolved through litigation in court. All this indicates that the Shenzhen SEZ has initially taken the road of administering the zone fully according to law.

Third, initial success is apparent in the use of foreign capital; Shenzhen's pioneering action in this respect provided an example for other SEZs to follow. Up to the first half of 1985, Shenzhen has signed 3,980 contracts with foreign businessmen, involving investments of more than \$3.2 billion, of which \$800 million have actually been invested and used. Over 30,000 items of machinery and equipment have been imported, of which more than 40 percent were

items of an advanced nature. Investors in Shenzhen, originally only several small enterprises, are by now also large foreign firms, large financial consortia and transnational corporations. The magnitudes of the single investments have also increased from originally only several ten thousand Hong Kong dollars to several hundred million U.S. dollars. On the other hand, the Xiamen SEZ has signed 247 contracts with foreign businessmen, up to the first half of 1985, involving the investment of \$1.04 billion (of which \$580 million is foreign capital). In the case of 72 of these projects, production and business operations have already started, with actual investments amounting to \$177 million. Xiamen has imported 24 production lines with 160 items of key equipment. The comparison indicates that Shenzhen is still advancing at a faster pace and is having a certain impact on the other SEZs.

Fourth, reforms of the economic and administrative systems have initially been carried out, providing reliable reference and experiences for the economic reform in the interior. During the last few years, Shenzhen has effected reforms of the traditional systems, following the directives of Comrade Hu Yaobang, "new things require new methods, special circumstances require special methods, our standpoint remains unchanged, but methods must be completely changed," and of Comrade Zhao Ziyang about having the SEZs extricate themselves from current systems. As regards its economic system, Shenzhen carried out a comprehensive and systematic reform of the planning, commodity pricing, banking, commercial and personnel affairs and worker wages systems and expanded the authority of enterprise management. For instance, in reforming the worker wages system, it instituted the labor contract system; for salaries and wages of employees in industrial enterprises, it instituted the system of structured salaries and wages. Even though further reforms are necessary in certain respects, the pattern of the structured salaries and wages served as reference for the reform of the wage system in all the industrial units of the country, begun in July 1985. As regards its system of capital constructions, Shenzhen instituted in its reform a system of comparisons and appraisals of designs, in the later execution of work a system of calling for bids, and a system of contracted responsibilities at all levels within the unit which had been successful in its bidding and had been entrusted with the work. In respect of its administration, Shenzhen followed the principle of simplification with increased efficiency and simplified the organizational structure, retrenched personnel and initially separated governmental administration from enterprise management. As regards the system of personnel administration, Shenzhen selected its cadres with emphasis on their ability, and without regard for status and seniority, allowing the masses an opportunity to give their vote of confidence and instituting a combined process of inviting applications, selections and appointments. In all these matters, experiments led to good results and in some respects have served as examples for reforms carried out in the interior.

Fifth, there is the first inkling of an export-oriented economy as the Shenzhen SEZ begins to function as a swing door that opens both ways. One special criterion of the export-oriented economy is that the quantity of its exports, which earn foreign exchange, must in value exceed 50 percent of the total value of its production. In the case of the present-day Shenzhen SEZ as a whole, the proportion of exports accounts for only 30 percent. However, in the case of the present-day Shekou industrial district, its industrial

projects are to 80 percent foreign-financed, and imported foreign capital accounts for more or less 60 percent of its total investments. In 1984 exports from the said district reached 70 percent of its industrial production, while statistics reveal that the value of its exported industrial products in the first half of 1985 has gone up to 80 percent of the value of its total production. (Footnote: SHEKUO NEWS issue No 9 trial publication August 1985) This indicates that considering only the Shekou sector of the Shenzhen SEZ, this is already basically an export-oriented economy. Yet, considering the Shenzhen SEZ as a whole, it cannot yet be regarded as an export-oriented economy, though we may say that it begins to show signs of becoming one, with the mentioned first indications of outward orientation.

The "swing-door" function of the Shenzhen SEZ is beginning to show effects, as evident in the following: 1) Some of its enterprises use domestic raw and semiprocessed materials and semifinished goods and are using imported technologies or a few items of key equipment to manufacture products that are breaking into international markets. For instance, the China Northern Industry Corporation and its subsidiaries manufacture in the above-described manner matrixes of various specifications, which are all exported and since 1981 have created foreign exchange to the amount of over HK\$10 million. They are filling an existing gap in domestic production by manufacturing the "Peacock" brand paint sprayers, and are also marketing these products in the international markets. 2) Some technologies, after being properly assimilated and adopted, have been transmitted to places in the interior, thereby promoting the development of national industries. For instance, the Aeronautic Standard Parts Factory under the Aero-Technology Shenzhen Industrial Trade Center, after assimilating and absorbing certain relevant technologies, passed this knowledge on to certain Chinese provinces and municipalities. Another example is the Kangle [phonetic] Electronics Corporation (a combined operation of pertinent Shenzhen and Harbin enterprises) which transmitted the technology for the manufacture of its Kh8282A dual-cassette radio cassette recorder to a certain Harbin factory, enabling that factory to manufacture new products, thereby gaining a profit of over 1 million yuan. 3) Some enterprises offered technology or project contracts to places in the interior, enabling the enterprises in the interior to catch up with the technological level of the SEZ. For instance, the Shenrong Engineering Plastics Manufacturing Corporation helped the Xingdi district of Kashgar by means of a technology contract to set up a plastic goods manufacturing plant. 4) Taking advantage of the favorable conditions of Shenzhen for a combination of imported technologies with the technical facilities of the interior to start manufacturing new products and introducing them into the international market. A cooperation of pertinent Shenzhen and Harbin enterprises (a joint investment with concerned departments in the interior), utilizing the above method, was successful in manufacturing a whole series of electronic nose [sic] products to international standards; some of these products are sold in countries as far away as Great Britain, Sweden, West Germany, Portugal and Saudi Arabia. 5) Utilizing imported equipment to manufacture articles in short supply in the interior, to effect "import replacements" and save foreign exchange. For instance, the 6 factories that are the only ones in China that manufacture magnetic heads for tape recorders cannot satisfy the demand throughout the interior. A pertinent enterprise in Shenzhen imported an advanced production line and as a result manufactures

magnetic heads that exceed the quality standards set by the ministry and have attained the quality level of Japanese products. The more than 6 million produced annually allows exports as well as filling the needs in the interior, thus saving foreign exchange otherwise required for their imports. Although the above are singular occurrences, they show an initial "radiating" effect toward overseas as well as toward the interior, the problem is now to bring about a further, more widespread realization; this will certainly still be a protracted procedure.

Sixth, with the SEZ's marvellous economic growth rate, the economic results too are on the rise year by year. Up to 1984, production was started by 609 industrial enterprises. Compared with before 1979, the value of industrial production has risen 29 times, the number of employees from somewhat over 87,400 to somewhat over 64,000, and the labor productivity of the entire work force has reached 28,000 yuan. The average total national output value per person has reached somewhat over 3,000 yuan. In the first half of 1985, the industrial output value of Chinese-foreign joint venture (cooperative management) and foreign financed enterprises in Shenzhen accounted for 6 percent of the total output value of the entire municipality, a 1.2-fold increase over the same period in 1984. During the period from January to May of 1985, the total value of export commodities was \$176 million, a 2.1-fold increase compared with the corresponding period of 1984. The above-stated conditions indicate clearly that developments in the Shenzhen SEZ during the last few years have been rapid, that economic results have been basically good and that certain successes have indeed been achieved.

But certain mistakes have also been made in the course of the construction of the Shenzhen SEZ. Precisely as pointed out in the article "Criticism and Analysis of China's Present SEZ's," published in the 27 August 1985 issue of the LIAO WANG monthly, mistakes have been made and problems have occurred primarily in two aspects: one is the excessively steep increase and too large a scale of the SEZ's investments in capital constructions; the other is the unscrupulous manner in which a part of the enterprises raised capital for their operations, giving rise to a new improper trend. Some departments imported large quantities of such consumer goods that were in great demand and resold them at high prices in the interior, some speculated in foreign exchange, etc. From November 1984 to March 1985, the Shenzhen SEZ checked over 300 large accounts of foreign exchange related to import-export transactions and found in 66 cases that foreign exchange had been traded in violation of the state's foreign exchange control. Although these improper practices have by now been stopped, the critical problem is what preventive measures must be taken against future trouble so as to allow the Shenzhen SEZ to develop toward an export-oriented economy.

## II. The General Demands and Salient Features of an Outward-Oriented Economy

Developing an outward orientation in the economies of China's SEZs requires the study of the general demands and peculiarities of the export-oriented economy. A survey of the countries and territories of the world where special economic zones and export-oriented economies exist shows that outward-oriented economies generally display the following salient features:

The principal characteristic of an export-oriented economy is that its markets have been established abroad, i.e., that it partakes of the international market at the rate of at least 70 percent of its production. The reason is that the so-called export-oriented economy is one which manufactures goods for the needs of the international market to which such goods are shipped. Should the foreign sales be 50 or less percent, one may only speak of a domestic-oriented economy. Why do we set the limit for foreign sales at 70 and not merely at 50 percent? First, if economies with 50 percent do not work well, their export proportion may indeed remain at 50 percent or below, which can hardly be called a primarily export-oriented economy, but only perhaps a mixed domestic-foreign trade economy or a primarily domestic-oriented economy. Second, the rate is set at 70 and not at

100 percent mainly out of the following considerations: some products may have to be sold domestically, and even though these will account for a smaller proportion, there will be a certain proportion of such domestic sales. There will also be products that are "import replacements," saving foreign exchange, and these products will also be of a certain proportion. Third, if the proportion of domestic to foreign sales is 4 to 6, we may say that there is a predominance of an outward orientation, but not a truly export-oriented economy. In view of what has to be generally demanded, therefore, it is only when the proportion of foreign sales reaches at least 70 percent that we may speak of an export-oriented economy. Of course, it would appear even better if greater efforts were expended and the proportion of foreign sales raised to 80 or 90 percent, but the matter of "import replacements" must never be left out of consideration; there is this objective fact.

Second, the quantity, color, design and the types of products manufactured by a country or territory that aspires to be regarded as of an export-oriented economy must be of world standards, i.e., of world class. Products of this quality must, furthermore, conform to international trends and modern international tastes. Although it may be possible to occasionally inject internationally substandard goods into the international market, they will be unable to withstand the test of the heavy competition in the international market, would be saleable only at cut-prices and losses and in the end, would be unable to maintain themselves and be returned. Even if they are sold abroad at a loss, with minimal economic results, their sale would not fulfill the requirements of an export-oriented economy.

Furthermore, the export-oriented economy requires that its main source of capital consist of foreign capital. The so-called foreign capital, thus, means capital from Hong Kong, from overseas Chinese or from other countries. The benefit of using foreign capital is not only the ability to buy modern advanced technologies and equipment in the international market, which helps improve products and hence also competitiveness in the international markets, but also the fact that the owners of the foreign exchange are cooperating with China and that their channels for marketing products in the international market can be used to help introduce our products in the international market. There should also be some domestic capital, mainly for domestic supplementary supplies, raw and semiprocessed materials, for the payment of salaries and wages to local employees, etc. However, most of the capital must be foreign capital, as it would otherwise be very difficult to change huge sums of domestic capital into foreign exchange to import new and advanced technologies

and equipment, and even more difficult in the case of countries whose currency is not directly linked with international currencies and is not freely convertible.

And what's more, an export-oriented economy requires personnel that is well qualified to transact foreign trade. This does not refer to a domestic or overseas disposition, but rather to a high degree of intelligence and the ability to conduct foreign trade transactions. For instance, workers should at least have had senior middle school education and know a foreign language to facilitate effective handling of foreign technologies and of the advanced equipment imported from abroad, also to be able to read blueprints and drawings and other technical data of foreign imports. Cadres in economic management positions must at least have an undergraduate-level university education, and in some special lines should be graduates with master and doctoral degrees. Proficiency in a foreign language is a basic requirement for them, and they must not only have a grasp of, but be able to apply with ease, knowledge of modern economic management, of international trade, of international commercial and tax laws, and of accounting and marketing as related to international markets. In the case of engineering cadres, there are additional demands with regard to their specialties. Within the scope of their specializations, they must be absolutely familiar with the latest domestic and foreign developments and also possess a certain creative spirit. In 1981 South Korea had 22,000 high-ranking personnel with master and doctoral degrees and plans to have 83,000 by the year 1991, furthermore plans to send 5,000 skilled workers to the United States, Japan and West Europe for advanced training, which clearly indicates that the development of an export-oriented economy is impossible without the training of export-oriented talents.

Finally, the strengthening of the export-oriented economic administrative organization to enhance the strength in foreign economic relations and trade. The export-oriented economy requires a foreign trade-agriculture-industry integrated guidance, which may also be said to be a guidance toward a "trade-industry-agriculture" pattern of primarily marketing products in the international market, with a reform of industry and organization and a corresponding strengthening of the economic administrative organization of the export-oriented economy. For instance, Singapore, one of the "four small tigers of Asia," in the course of setting up the Jurong Industrial Estate to promote an export-oriented economy, paid close attention to the establishment of a highly effective administrative organization with centralized powers. In 1961 an Economic Development Bureau was set up at Singapore, primarily charged with working out the pertinent investment policy, determining domestic and foreign capital investments in industries and with the examination and approval of investment projects, also to determine the procedure for investment applications. In case of necessity it was empowered to directly participate in projects by taking up shares, to assist factories in solving specific problems met with in the process of investments, to grant loans to factories and render supportive services. It carried out standard inspections of products from enterprises having received investments, trained personnel needed for the industrial district, provided the factories with industrial land and standard factory buildings, etc. In June 1969 Singapore again specially set up a Jurong City Administration. The Economic Development Bureau specially concerned itself with the importation of capital, the City

Administration was responsible for opening up the district and for its administration. The limited number of departments and administrative levels and their high efficiency, facilitated investments and business operations by foreign businessmen and promoted the development of the processing district into an export-oriented economy (Footnote: "Survey of the World's Special Economic Zones," compiled by the Institute for the Special Zones of Hong Kong and Macao at the Jinan University, p 119). In guidance toward foreign trade, strengthening the administrative organization for foreign economic and trade relations is also very important. If weakness is shown in foreign economic and trade relations and if things are handled with little intelligence, it would be futile to attempt to establish an export-oriented economy.

As a matter of fact, the general demands of an export-oriented economy are not limited to the above-stated few aspects. The problems have to be given close attention also all the way from the five factors of production--workers, work tools, work objective, capital, market--as manifested in the microeconomy right up to the macroeconomy. The work object, i.e., whether the quality of the raw and semifinished materials is good or bad, whether supply is sufficient, whether productivity is up to international standards, all these factors around the quality of the product directly affect the proportion of products marketed abroad and, furthermore, affect the nature of developments, whether they would be domestic-oriented or export-oriented.

### III. Conditions and Methods of Transforming Shenzhen's Economy From a Domestic-Oriented to an Outward-Oriented Economy

Apart from the Shekou industrial district, which has indeed assumed an export-oriented character, the current economy of the entire Shenzhen SEZ is still in a state of a domestic-oriented economy. To accelerate the shift toward an export-oriented economy in Shenzhen, it is the opinion of this writer that close attention must be paid to the following problems:

1. We have to realize that the developmental law of the SEZ's technological progression is a movement from low to medium to high level development; we must create conditions conducive to an accelerated technological escalation in the SEZ and to a shortening of the time required for the shift from a domestic-oriented to an export-oriented economy. Some believe, "having operated for 5 years and only 30 percent of its products earning foreign exchange, thus still not yet attaining 'outward orientation,' is tantamount to failure." In my opinion this is too lopsided a viewpoint. Just as one meal cannot make a lean person fat, the SEZ cannot become export-oriented in only 3 or 5 years. One demand of an export-oriented economy is technological progress, but such progress cannot be achieved as an instant result, but must be allowed to develop in a protracted process. Speaking of the well-known case of the "No 2 in Asia," Singapore (second only to Japan), that place had to undergo three successive stages in its development to an export-oriented economy with the use of foreign capital. The first stage, from 1959 on, was a stage of "import replacements." During this stage, Singapore clearly and definitely had designated labor-intensive industries as key areas for investments, actually at a time when the employment of advanced technologies was of course still out of the question. The second stage began more or less in 1967 and was a stage of "orientation toward exports," with investments



being directed to the export-oriented industrial sector. The third stage started more or less in 1975 and was a stage of "technological escalation," when the focus of investment activities was gradually shifted to the capital-intensive and technology-intensive industrial sector. As from 1979 on, a series of policies was instituted that gradually eliminated labor-intensive industries and promoted the flow of capital into the technology-intensive and knowledge-intensive industrial sector of high technology, high-level techniques and high profitability. Generally speaking, each technological escalation required 7 or 8 years, and each escalation was one step closer to an export-oriented economy. As a matter of course, turning Shenzhen's economy into an export-oriented economy will also require a somewhat protracted process, and technological escalation too requires a somewhat protracted process. It is of course debatable, however, whether each stage in the process must take 7 or 8 years; we must on principle try to shorten the time as much as possible, because we are not only in a position to benefit from the experiences of the various other special economic zones throughout the world, but are also a country of planned commodity economy. In view of these two factors, it should be possible for us to shorten the time for the transformation of the SEZ economy into one of outward orientation. Precisely as the article "Criticism and Assessment of China's SEZs" (CHAN WANG monthly, 27 August 1985) pointed out, it is an indispensable phase during the initial stage of the SEZ that it engage to some measure in such types of outward-oriented economic activities as tourism, the three forms of import processing and compensation trade (importing materials for processing, importing samples for processing, importing materials for assembly and compensation trade). The present problem is that we must start out from "the bottom of the hill," the improvement of the investment environment, and steadily progress toward "the top of the hill," the truly export-oriented economy. After recognizing the regularity in these stages of development toward an outward-oriented economy and recognizing the step-by-step nature of technological progress, we must consciously create favorable conditions conducive to the acceleration of technological progress and to the process of transformation toward an export-oriented economy. Speaking of importing technologies, we have indeed imported a large number of lower-level and medium-level technologies, the crucial question is now to import comparatively advanced and truly advanced technologies and to exert all efforts to improve the technological structure of the SEZ as soon as possible, exert efforts to further advance technologically and have the technological escalation spur on the economy of the SEZ to accomplish the shift from a domestic orientation to an outward orientation and to bring its subjective dynamic force into play to shorten the time for this process of transformation.

2. A thorough understanding of the importance of a high-quality labor force for the transformation of Shenzhen's economy from a domestic-oriented to an export-oriented economy and earnest attention to the task of nurturing talents for export-oriented operations. There are statistics that show that Shenzhen Municipality's labor force consists of 120,000 persons, of whom 42 percent have had a senior middle school or higher education and 8 percent are of junior middle school or lower educational level. Among the contingent of about 20,000 cadres, 27.8 percent have had a university or college education, 23.3 percent have had technical secondary school education, 20.7 percent have had senior high school and 28 percent junior high school or lower education.

After several years of training, the general educational quality seems quite good, but there are two problems that must have our serious attention: One is whether the educational level is adequately matched by an ability to actually deal with foreign economic affairs, and the other problem is to have old knowledge freshened up and to have recent graduates from institutions of higher learning continue their studies. The most pressing need is therefore, as mentioned, the need for talents with educational and managerial qualifications fit for the tasks of the export-oriented economy. There are not many in all of China who qualify in these respects, and possibly also not enough in Shenzhen. What is to be done? We must pay close attention to training. In the course of our training, there must be no pursuit of formal objectives, but the teaching of genuine capabilities. The additional knowledge that must be imparted has to be mainly related to foreign economic relations and trade, advanced science and technology, modern management and foreign languages. Studies must, furthermore, be supplemented by materials from actual cases in the fields of production, market operations and modern management. Studies should also be checked in strict examinations. As recently reported in the press, five cases of economic fraud have in recent months been exposed in the Shenzhen SEZ, the defrauded amounts totalling RMB 2.3 million yuan, \$550,000 and HK\$1.17 million, of which 97.95 percent was defrauded by lawless elements from Hong Kong. (Footnote: "Beware of Hong Kong Swindlers," YANGCHENG WANPAO, 30 August 1985) This case clearly illuminates from one angle that some of Shenzhen's cadres, staff and workers still lack economic and legal knowledge needed in dealing with foreign merchants, that it remains a matter of extreme urgency to strengthen the training of talents in this respect, that this work must be placed on the order of the day and it must be tackled comprehensively and in a well-planned manner.

3. We must adhere to a policy of primarily utilizing foreign capital for the basic construction requirements of the SEZ and must pay close attention to the actual use of this foreign capital. According to statistics for the period from 1980 to June 1985, total investments in the Shenzhen SEZ are somewhat over 4.6 billion yuan, of which 22.5 percent constitute the use of foreign capital, 36.5 percent are bank loans, 25.6 percent are funds raised by the financial authorities and enterprises of the SEZ, 11.6 percent are investments the central authorities, ministries, provinces and enterprises in the interior and only 3.8 percent are state investments. It is of course quite an achievement for the Shenzhen SEZ to have accomplished the present scale of construction with so little state investment. Yet, judging by the overall objective of primarily relying on the importation of foreign capital as funds for the SEZ's construction, the objective has not yet been fulfilled with only 22.5 percent of foreign investments. Up to June 1985, the contracts signed by Shenzhen with various foreign firms involved investments of somewhat over \$3.2 billion, of which only \$800 million have actually been remitted and used, i.e., only about 25 percent of the investments contracted for have actually been used so far. This shows that Shenzhen must still endeavor to achieve a larger proportion of foreign capital investments within the overall investments in the SEZ in the course of its shift to an export-oriented economy, and that it must give serious attention to increasing the actual participation of foreign capital. Much work is still required in this respect until preconditions are created for the transformation of the Shenzhen economy to one of outward orientation.

4. The industrial structure of the Shenzhen SEZ must undergo reexamination, with special attention to be given to rendering the industrial structure more export-oriented. As it appears from an examination of the respective proportions of the three categories of industries, Shenzhen should from top to bottom follow an order of progression of from tertiary, to secondary and to primary industries. In tertiary industries, emphasis should be placed on information and banking industries, in the secondary industries the primary emphasis should be on such light industries such as the electronics industry, and among the primary industries priority should be on the fishing industry and production of fresh and life agricultural products. Looking at the current conditions, statistics up to 1984 show that the output value of Shenzhen's tertiary industries is about 800 million yuan, accounting for 41 percent of the GNP of the entire municipality, the highest rate throughout the country. In all economically developed countries and territories of the world it is 50 and more percent. In 1982 the tertiary industries in the United States accounted for 65.8 percent of the output value of all three categories of industries, in Great Britain for 62.8 percent and in Hong Kong for 70.5 percent. Much work remains to be done in Shenzhen in this respect, and particular emphasis will have to be placed on the development of the outward-oriented tertiary industries. Although the secondary industries in the SEZ have by now been developed to a certain extent, especially the electronics industry, the majority in this category is of the character of the "three forms of import processing and compensation trade," most of the raw and semifinished materials, electronic parts and components are imported from abroad and most of the products are then exported after assembly. This is an unavoidable development during the initial stages of the SEZ. The crucial point is now that we must assimilate, absorb and creatively develop, so as to transform the "three forms of import processing and compensation trade" character into fully creative industries of our own. The same is true for the other branches of the light industry; they all present the problem of how to transform the processes into industries of our own through absorption and creativity. Main components of the primary industries are agriculture, forestry, animal husbandry and fishery. Shenzhen should give priority to the development of an export-oriented agriculture and fishery. Those departments in the SEZ that are in charge of promoting the importation of foreign capital and technologies must first of all restudy the developmental policy of the past and adjust this policy to meet the demand for an export-oriented economy. Only then, after adjusting that developmental policy, and having arrived at proper proportions and a proper structure for the three categories of industries, should the importation of foreign capital, technologies and equipment be undertaken, turning passivity into activity, so that Shenzhen will develop on a straight road to an export-oriented economy, with few circuitous aberrations or none at all.

5. We must pay utmost attention to the role of a market regulation that will be subject to the guidance of the state's macroeconomic planning, especially also to the regulatory and restrictive role of the international market on the economic development of the Shenzhen SEZ, and must conscientiously guide Shenzhen's economy in a development toward outward orientation. During a certain period of time, some comrades, either theorists or persons in actual practice, have in the past engaged in a discussion of an economic regulatory

mechanism for the Shenzhen SEZ and had been fairly unanimous that Shenzhen should make full use of the market mechanism and give full play to the guiding function of market regulation. There is really nothing wrong in putting it this way; the problem is only that most discuss the market in an abstract way, and few define which particular market regulation should be given priority. As a result, the market regulation reflected in the practices of the Shenzhen SEZ is the market regulation of within the SEZ or the domestic market regulation within China. There are even those who have raised the question of Shenzhen's trade (i.e., the zone's internal trade) be "placed in command." This writer is of the opinion that this whole question must be reexamined. A market regulation primarily based on the SEZ market would undoubtedly still make it a kind of domestic-oriented economy, with the zone itself producing and marketing its own products. Only by emphasizing that the international market is to be the primary factor of market regulation for the Shenzhen SEZ will Shenzhen's economy be made to develop according to the needs of the international market, will it adjust its own industrial structure, its product mix, its employment structure and truly, in name and in fact, go the way of an export-oriented economic development. Since we have to accept the fact that Shenzhen's economy must primarily be subject to the international market regulation, we must acquaint ourselves with the international law of value--the law, and the function of the law, that the value of products for sale abroad is determined by "the average unit of world labor," and we must, furthermore, give attention to the development of our information, banking and science and technology-related industries. Otherwise, speaking of transforming the Shenzhen economy into an export-oriented economy would be nothing but empty words.

6. We must carry out a further and more thorough-going reform of our economic system, following the initial reforms in Shenzhen, and must establish an economic system consonant with Shenzhen's development toward an outward-oriented economy. In several years of great effort, Shenzhen has carried out an initial reform of its economic system which--as we have to acknowledge--serves as a good example for reforms to be carried out in the interior. However, was it a completely perfect reform, and did it accomplish the whole task at one stroke? The answer is in the negative. For instance, speaking of the personnel system, the statistics show (as mentioned earlier) that the quality of personnel in the SEZ seems to be not at all bad, i.e., personnel is of a high educational level (most are of senior middle school and higher levels). But that does not mean, we are afraid, that all these people have a certain foreign language ability, or skills to deal with foreign merchants, or are capable of properly marketing goods in the international market. Among ordinary graduates from institutions of higher learning there are generally students with "good marks and little ability, or with bad marks and high ability," and would that not also be the case in Shenzhen? In my opinion we must face up to this fact. To resolve the problem of a high quality of export-oriented intelligence in personnel for export-oriented operations, one way is to train and test currently employed personnel, and the other way is to bear the above facts in mind when newly employing personnel, as not every graduate from a senior middle school or higher institution is fit to be employed (only those showing good prospects with further training are the exception). This requires a further reform in the system of personnel administration. Speaking, furthermore, of the worker wage system, there are

two topics to consider: one is the way in which labor is being employed. This problem must be thoroughly dealt with at the time of employment of staff and workers--a system of signing labor contracts should everywhere be adopted. However, for personnel in government agencies and enterprise units, apart from workers, jobs seem to be still without exception on a fixed basis, still of the "iron rice bowl" type, and there still seems need for further reforms toward an identical system for employees (a contract system). The other topic to consider is the wage system. This system has been changed in the industrial units, but among the enterprises each seems to do things in its own way. The average wage in the industrial units is 189 yuan, with very little differentiation in grades. The problem that exists here is whether the wage levels are appropriate and that there is the danger of an egalitarianism with the small wage differentials between grades. This would, therefore, require further reforms, which would also be correspondingly needed in the wage system of enterprise units. The other systems, such as relevant to planning, materials supplies, finance and banking and foreign trade, must also free themselves of current institutions and institute further reforms as demanded by the trend toward an export-oriented economy. Through reforms we must establish export-oriented systems that are particularly suited to the export-oriented economy, so as to accelerate the transformation of the Shenzhen economy from a domestic-oriented to an export-oriented economy.

The basic characteristics of an export-oriented economy, and how to transform the Shenzhen economy into an export-oriented economy, constitute new and important problems in China's economic development. There are no ready-made theories, nor are there any ready-made Chinese examples to follow. The above are merely initial exploratory ideas of this writer, containing, unavoidably, some erroneous concepts. It is hoped that comrades in the theoretical field and those in actual practice will join me in these explorations of the problem, so as to accelerate efforts that will transform the SEZ economy from a domestic-oriented to an export-oriented economy.

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## SPECIAL ECONOMIC ZONES

### SHENZHEN INTENSIFIES EXPORT WORK

Hong Kong TA KUNG PAO in Chinese 30 Jun 86 p 6

[This article appeared in the "Economic Zone" column (column published Mondays): "The Associated Foreign Traders Corporation of Shenzhen Vigorously Develops Foreign Trade--Plans Offices in West Germany, the United States, and Singapore, Also To Promote Sales by Trade Fairs, Exhibitions, and Mini-Fairs"]

[Text] The Foreign Trade (Associates) Corporation in the Shenzhen Special Economic Zone [SEZ], gearing its activities to the Shenzhen SEZ's shift toward an "outward orientation," is this year undertaking a further development of its export business, striving to reach a target of \$150 million in its exports.

This is the first year of the Seventh 5-Year Plan, a year in which the SEZ enters a phase of readjustment, consolidation, and improvements, when all industrial units of the SEZ will be making great efforts to gradually develop products that will sell well in the international market. The Foreign Trade (Associates) Corporation of the Shenzhen SEZ, which is one of the outlets for the export products of the SEZ, will appropriately coordinate its business activities, so as to get more products of the SEZ into the international market.

To promote foreign trade, the said corporation plans this year, in addition to operating its original 42 export factories and fair grounds, to expand developments further, open up new sources of export commodities, and gear production to sales, to the measure that these will indicate the demand in the international market. The said corporation will regularly dispatch personnel abroad to gather information on trends in the international market, that will enable arranging production of "preferential items," which should be those that quickly adapt to the changing trends, have short production cycles, and of which there is a shortage in the market. After careful research, the corporation is at the same time preparing to invest in one or two enterprises, to be newly established, for such lines that command a good market overseas and that will operate at a certain advanced level of technology, to effectively concentrate on the manufacture of export products. The said corporation has selected the Nanshan and Shekou districts of the SEZ for the development of foodstuffs, beverages, and medicinal materials, the Nantou Tongle area as center for the development of ramie products, cotton spinning,

plastics, lamps and lanterns, window curtains, gloves, garments, camlet, and other such products, and the Pingshan district as comprehensive production base for the development of such export products as chicken, pigeons, quail, snakes, fodder, fish, and fruit.

To improve the export competitiveness of products, the corporation will take measures to strengthen refrigerating facilities for fresh and live commodities, to ensure their freshness, and enhance the quality of the products. In addition, the corporation will energetically pursue the processing and refining, as well as expert packaging, of agricultural and sideline products obtained from the interior, so as to make them suitable for the international market.

It is understood that the products presently made available for export by the Shenzhen Foreign Trade Corporation are already being marketed in such far away countries and territories as the United States, West Germany, Japan, Italy, Holland, Canada, Australia, and Southeast Asia. To open up additional markets abroad, the said corporation intends to set up offices in West Germany, the United States, and Singapore, to be charged with expanding business in the various neighboring territories. To arrange further sources of supplies, the said corporation, furthermore, plans to take up contacts with provinces and municipalities in the interior and through export agency arrangements promote export trade of provinces and municipalities in the interior, which will create more foreign exchange for the state. The corporation, moreover, plans to employ such forms as trade fairs, exhibitions, and mini-fairs to establish contacts with Chinese and foreign firms to develop further business.

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SPECIAL ECONOMIC ZONES

SHENZHEN ESTABLISHES EXPERT PANEL TO REVIEW IMPORTS

Beijing RENMIN RIBAO in Chinese 4 Oct 86 p 3

[Article by Wang Yougong [3769 0645 1872]: "Shenzhen's Technology Imports Now Must Be Approved by Experts: If the New Appraisal Commission Passes Negative Judgment on a Project, Review Departments in Principle May Not Grant Approval"]

[Text] The Shenzhen Technology Import Advisory and Appraisal Commission was formally established 29 September to help the city government import good technology.

Technological import work, a key link in the Shenzhen Special Economic Zone's program of opening up to the outside world, has advanced in recent years. Nevertheless, the zone's inexperience has made such problems as insufficient proof of feasibility and blind and redundant importing unavoidable. Improvement in the approval system and in the quality of technological imports, therefore, have become top priorities in the zones import work. Thus the city government appointed 38 expert engineer specialists to form a semi-official, nonprofit and authoritative technological appraisal and consultative agency. At government request, this agency will provide advice on general technological development planning; produce evaluations of the degree of advancement, applicability and economy of technological imports; submit various appraisals to approval departments for reference; and make suggestions on how to absorb, adapt, develop and make new innovations with the technology and equipment imported by enterprises.

The Shenzhen City government has ordered that all important technology imported by the SEZ must be reviewed by this brain trust and that, if the commission passes negative judgment on an import, approval departments in principle may not grant approval.

The commission has already submitted evaluations of 10-plus technological imports. These reports not only appraised the degree of advancement, feasibility and economy of those imports but also suggested revisions of agreements in which start-up costs were too high and contracts were too long and of such matters as the amounts of stock shares apportioned in return for technology transfers, grants of preferential treatment and property rights.

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CSO: 4006/68



5 December 1986

## TRANSPORTATION

## PLAN TO STRENGTHEN RAILROAD NETWORK IN EAST CHINA ANNOUNCED

Beijing RENMIN RIBAO OVERSEAS CHINESE EDITION in Chinese 16 Sep 86 p 1

[Article by Cao Zhaoqin [2580 3564 3830] and Pan Yanxi [3382 5888 5045]: "A Great Plan for Railroad Development in East China Has Been Unveiled; This Plan Will Meet the Needs of Our Developing Economy and of the Four Modernizations and Calls for an Improvement of the Beijing-Shanghai Line, a New Trunk Line in East China and Double-Tracking of the Zhejiang-Jiangxi Line"]

[Text] It is has been learned that the Ministry of Railways has drawn up a program to accelerate railroad development in East China so as to eliminate shortage in the region's transport capacity. This program provides for improvement of the Beijing-Shanghai line, construction of a second trunk line in the region and double-tracking of the Zhejiang-Jiangxi line during the Seventh 5-Year Plan. The Ministry of Railways recently convened a conference of experts from various quarters, and these experts examined and finalized the plans in an atmosphere of respect for democracy and esteem for science. Upon completion, the program will substantially increase rail transport capacity in East China.

It is reported that the program to accelerate railroad development in East China will be one of the three great battles for which the Ministry of Railways plans to mobilize its forces during the Seventh 5-Year Plan, namely, an assault on Hengyang and Guangzhou in the south, the campaign for Daqin [Greater Shaanxi] in the north and the seizure of the east in central China. Deployment has already been set and action commenced on the plans to double-track the Hengyang-Guangzhou line and to build the Daqin railroads, so construction on the East China rail network has become even more urgent.

Experts attending the conference convened by the Ministry of Railways unanimously agreed that East China is the economic heart of China and has a decisive effect on the industrial and agricultural development of the entire nation. Yet, the experts noted, East China's transport capacity has seriously failed to keep pace with the region's economic development, there is a severe shortage of passenger capacity, freight often fails to get loaded and is delayed due of a shortage of space, and three of the four greatest bottlenecks in the nations railway system are located in the region. Therefore, the experts concluded, we urgently need to speed up railroad construction and to increase rail transport capacity in this region.

At the conference, the experts focused their discussion on a comparison of plans for improving the first trunk line East China, building a second trunk line in the region and improving the Zhejiang-Jiangsu and Hangzhou-Lanxi lines.

The experts decided that, in order to increase transport capacity in East China, we must improve the Beijing-Shanghai line by vigorously adopting modern technology, equip the line with advanced technology as rapidly as possible and make the line a model for middle-level modernization of the nation's rail system.

The conference concluded that we must build a second trunk line in the region as quickly as possible. The experts believed that improvement of the Beijing-Shanghai line, which project is also fraught with technical difficulties that will require a certain amount of time and concentrated effort to resolve, cannot be expected to alleviate congestion in the region's railroad network in the near future and thus that it is very urgent that we open a second trunk line into the region.

The experts studied many proposals concerning the routing of the second trunk line, repeatedly compared the economic and technical advantages and shortcomings of seven possible routes for the line and unanimously concluded that, under present conditions, the most suitable route is the Shangqiu-Fuyang-Hefei-Wuhu-Xuancheng-Hangzhou line. This route requires construction of two new sections, from Shangqiu to Fuyang and from Xuancheng to Changxing, and appropriate improvement of the Fuyang-Huainan, the Huainan and the Hangzhou-Changxing lines; the section from Wuhu to Xuancheng on the Anhui-Jiangxi line; and the ferry from Wuhu to Yuxikou, also on the Anhui-Jiangxi line.

The experts believed that we must step up efforts to double-track the Zhejiang-Jiangxi Railroad. This line, the only railroad linking the Shanghai economic region with with Southeast, the Central South and the Southwest, has one of the tightest passenger and freight capacities in the nation. The experts suggested that a second bridge across the Qiantang Jiang be built so as to meet growing transport demand and to ensure that traffic on the Zhejiang-Jiangxi line, a great artery between the east and west, flows smoothly.

The experts also devoted much discussion to the need for and timing of construction of the Hangzhou-Lanxi and Suzhou-Jiaxing lines as well as other issues.

12431  
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TRANSPORTATION

BRIEFS

**YENAN LINKED TO RAIL SYSTEM**--The Poqin section of the Yanan Railroad, for which the people of this old revolutionary base have long yearned, was completed and opened to traffic 25 September, thus bringing the railroad to northern Shaanxi for the first time in history. The Yanan line (from Xian to Yanan), which ultimately will have a total length of 315 km, will be northern Shaanxi's only rail link to the rest of the nation, serve as a major artery between the northern and southern halves of the province and be of decisive importance in developing the rich coal and petroleum resources of the north. The railroad is the first in Shaanxi to be jointly funded and constructed by the state, local government and railway departments. 4,000 workers from the Ministry of Railway's First Construction Bureau, which undertook the project, struggled day and night against great hardship and completed the 93 km-long Poqin section more than 100 days ahead of schedule (work having begun 1 May of last year), and thus far 198 km of the railroad have been opened to traffic. At 12:00 A.M. 25 September, the first coal train left Qinjiachuan Station in Huangling County for Xian. [Text] [Beijing JINGJI RIBAO in Chinese 1 Oct 86 p 1] 12431

**ANHUI-JIANGXI RAILROAD**--In the 2 years since 1984, when the Anhui-Jiangxi Railroad was turned over to the state and began to operate, the entire line has carried over 8 million tons of freight, exceeding planned targets for the early stage of operations by 40 percent. Starting in the north from Huolonggang Station on the Ningtong Railroad and connecting in the south to the Zhejiang-Jiangxi Railroad, the line has a total length of 540 km and is a major artery linking the 5 provinces of Jiangsu, Anhui, Zhejiang, Jiangxi and Fujian. Since opening to traffic, the railroad has diverted over half of the freight that used to be shipped to Shanghai, Jiangxi and Fujian via the Tianjin-Shanghai line, and goods from the southern Shanghai region can also travel south via this new route after first passing over the Southern Shanghai Railroad and ferrying across the Chang Jiang at Yuxikou. According to statistics, for two items alone--coal transported to Fujian and Jiangxi from mines in Huainan and Huaibei and lumber transported from Fujian and Jiangxi to Jiangsu, Shandong and Anhui--the Anhui-Jiangxi line has saved more than 34.1 million yuan in shipping costs. [Text] [Beijing JINGJI RIBAO in Chinese 1 Oct 86 p 1] 12431

**BRIDGE SPANS HUANG HE**--After 2 years and 3 months of intense construction work, the 5,500-plus-meter-long Zhengzhou Huang He Bridge, the longest highway

bridge in China, has successfully opened to traffic. A grand dedication ceremony was held for the bridge on the morning of 30 September. At this event Comrades Wan Li [5502 6849], CPC Central Politburo member and vice premier, and Yang Xizong [2799 2649 4844], secretary of the Henan provincial CPC committee, cut a ceremonial ribbon, and Huang Hua [7806 5478], vice chairman of the NPC Standing Committee, and Liu Zhengwei [0491 2973 1218], vice secretary of the Henan CPC committee, unveiled a tablet bearing an inscription by Deng Xiaoping which read "The Zhengzhou Huang He Bridge." The road surface of the bridge proper measures 18.5 meters in width, and the bridge has a total of 137 spans. Actual construction was completed 21 months ahead of schedule. [Text] [Beijing JINGJI RIBAO in Chinese 1 Oct 86 p 1] 12431

ANHUI BUILDS FIRST FREEWAY--These days "time is money," so people are willing to trade a huge sum like 400 million yuan for 2 and 1/2 hours. Anhui's first first-grade highway, on which work commenced 1 October, will shorten the amount of time it takes to get from Hefei to Nanjing from the current 4 hours to 1 and 1/2. This superhighway will cross the middle part of Anhui province from Longtang in Feidong County in the west to the Anhui-Jiangsu border at the 25-km marker on Hepu Rd in the east, have a total length of 110 km, be a limited-access divided highway that is intersected only by flyovers and have a speed limit of 120 km per hour. The highway is a key national construction project, will cost an average of 3.65 million yuan per km to build, is expected to be completed and opened to traffic during the Seventh 5-Year Plan and will play an important role in developing Anhui's economy and in strengthening the province's links with the Shanghai economic region. [Text] [Beijing JINGJI RIBAO in Chinese 1 Oct 86 p 1] 12431

NEW CHANGCHUN-JILIN HIGHWAY OPENED--The Northern Changchun-Jilin Highway, an important artery linking these two cities, was completed and opened to traffic 23 September. A key construction project in the province of Jilin, the highway required an investment of 100 million yuan and has a total length of 112 km, of which 4 km are ranked as first-grade highway, 4.4 km as superior second-grade and the rest, second grade. The nation's most advanced reflecting signs were installed along the entire route to ensure safe night driving, advanced construction technology and equipment were used to build the road and surfacing took only 1 and 1/2 years to complete. The new highway will permit speeds double those on its older counterpart in the south, reduce shipping costs by about 40 percent and, if we assume traffic levels equal to the highway's designed capacity, lower fuel consumption by 1.47 million liters annually. [Text] [Beijing JINGJI RIBAO in Chinese 1 Oct 86 p 1] 12431

PORT EXPANSION PROJECTS--Beijing, 1 Nov (XINHUA)--China has completed 20 new deep-water berths and other port expansion projects this year, the PEOPLE'S DAILY reported today. As a result, China now has a total of 199 deep-water berths, each capable of accommodating 10,000-ton ships. According to the paper, the expansion will allow a more even distribution of cargo among China's ports and help alleviate bottlenecks. For example, it said, the 10 new deep-water berths in the lower reaches of the Yangtze River in Jiangsu Province "have taken some of the pressure off the port of Shanghai." [Text] [Beijing XINHUA in English 0754 GMT 1 Nov 86] /9604

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CHINESE MEDIA ON FOREIGN ECONOMIC AFFAIRS

SOVIET UNION ANNOUNCES REFORM OF FOREIGN TRADE SYSTEM

Shenzhen SHENZHEN RIBAO in Chinese 25 Sep 86 p 3

[Article: "The Soviet Union Announces a Program to Reform Foreign Trade: State Corporations May Freely Trade with Western Nations"]

[Text] According to a report from Reuters News Agency, the Soviet Union announced 23 September that it would effect a major readjustment of its foreign-trade system and give state corporations greater autonomy in conducting business with Western nations. This represents a step forward in the Soviet Union's efforts to establish a more competitive economy.

According to a summary of the proposed reform measures included in a decree published in the Soviet official press, a small number of Soviet departments and corporations will be allowed independently to conduct trade with the West and the Third World beginning next year.

This decree will terminate the monopoly of the Minister of Foreign Trade over this activity. These new measures are in line with the other limited economic reforms carried out since Gorbachev was appointed leader of the Soviet Union in March of last year.

Western economic analysts believe that the Soviet trade reforms are closely related to that nation's desire to enter the GATT and its recent frequent negotiations with foreign companies to establish joint-equity enterprises in the Soviet Union. These analysts say that foreign companies are expected to benefit from the new Soviet foreign-trade system but that Soviet state agencies and enterprises will be under greater pressure to strive to increase exports due to the inevitable resulting rise in imports.

An official Soviet decree stated that the foreign-trade reform will greatly increase the responsibility of the enterprises involved. Under the new system, these enterprises will have to render compensation in hard currency for any losses resulting from failure to meet export targets or to fulfill export obligations.

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